(27)

No. 04-163
Title: Linda Lingle, Governor of Hawaii, et al., Petitioners
v.
Chevron U.S.A. Inc.
Docketed: August 4, 2004
Lower Ct: United States Court of Appeals for the Ninth Circuit
Case Nos.: (02-15867)
Decision Date: April 1, 2004
Questions Presented

~~Date~~~	~~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~~~
Jun 18 2004	Application (03A1040) to extend the time to file a petition for a writ of certiorari from June 30, 2004 to July 30, 2004, submitted to Justice O'Connor.
Jun 21 2004	Application (03A1040) granted by Justice O'Connor extending the time to file until July 30, 2004.
Jul 30 2004	Petition for a writ of certiorari filed. (Response due September 3, 2004)
Aug 26 2004	Consent to the filing of amicus briefs in support of either party received from counsel for the petitioner
Aug 31 2004	Consent to the filing of amicus briefs in support either party recieved from counsel for the respondents.
Sep 2 2004	Brief amicus curiae of Service Station Dealers of America filed.
Sep 3 2004	Brief of respondent Chevron U.S.A. Inc. in opposition filed.
Sep 3 2004	Brief amici curiae of New York, et al. filed.
Sep 3 2004	Brief amici curiae of National Conference of State Legislatures, et al. filed.
Sep 3 2004	Brief amicus curiae of League of California Cities filed.
Sep 14 2004	Reply of petitioners Linda Lingle, Governor of Hawaii, et al. filed. (Distributed)
Sep 15 2004	DISTRIBUTED for Conference of October 8, 2004.
Oct 1 2004	Supplemental brief of petitioners filed. (Distributed)
Oct 5 2004	Supplemental brief of respondent Chevron U.S.A. Inc. filed. (Distributed)
Oct 12 2004	Petition GRANTED.
Nov 4 2004	Extension of time within which to file the joint appendix and petitioner's brief on the merits to and including December 3, 2004.
Nov 4 2004	Extension of time within which to file the joint appendix and petitioners' brief on the merits to and including December 3, 2004.
Nov 30 2004	Consent to the filing of amicus briefs in support of either party received from counsel for the petitioners.
Nov 30 2004	Consent to the filing of amicus briefs in support of either party received from counsel for the respondent.
Dec 3 2004	Brief amicus curiae of United States filed.
Dec 3 2004	Joint appendix filed.
Dec 3 2004	Brief of petitioners Linda Lingle, Governor of Hawaii, et al. filed.
Dec 3 2004	Brief amicus curiae of National Conference of State Legislature, et al. filed.
Dec 3 2004	Brief amici curiae of Service Station Dealers of America filed.
Dec 3 2004	Brief amici curiae of New York, et al. filed.

Dec 3 2004	Brief amicus curiae of American Planning Association filed.
Dec 3 2004	Brief amicus curiae of League of California Cities filed.
Dec 15 2004	SET FOR ARGUMENT ON Tuesday, February 22, 2005.
Dec 16 2004	CIRCULATED.
Jan 3 2005	Brief amicus curiae of Manufactured Housing Communities of Arizona, inc. filed. (Distributed)
Jan 3 2005	Brief amici curiae of Pacific Legal Foundation, et al. filed. (Distributed)
Jan 5 2005	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Jan 5 2005	Extension of time within which to file respondent's brief on the merits to and including January 14, 2005.
Jan 5 2005	Brief amici curiae of Charles W. Coupe, et al. filed. (Distributed)
Jan 14 2005	Brief amicus curiae of National Association of Home Builders filed. (Distributed)
Jan 14 2005	Brief of respondent Chevron U.S.A. Inc. filed. (Distributed)
Jan 14 2005	Brief amici curiae of Equity Lifestyle Properties, Inc., et al. filed. (Distributed)
Jan 14 2005	Brief amicus curiae of Cato Institute filed. (Distributed)
Jan 14 2005	Brief amici curiae of Small Property Owners of San Francisco Institute, et al. filed. (Distributed)
Jan 14 2005	Brief amicus curiae of Actior Apartment Association, Inc. filed. (Distributed)
Jan 24 2005	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Feb 11 2005	Record received from U.S.C.A. 9th Circuit. (1 envelope)
Feb 15 2005	Reply of petitioners Linda Lingle, Governor of Hawaii, et al. filed. (Distributed)
Feb 17 2005	Record received from U.S.D.C. District of Hawaii. (2 boxes)
Feb 22 2005	Argued. For petitioners: Mark J. Bennett, Attorney General, Honolulu, Hawaii; and Edwin S. Kneedler, Deputy Solicitor General, department of Justice, Washington, D.C. (for United States, as amicus curiae.) For respondent: Craig E. Stewart, San Francisco, Cal.

No. (1)
Supreme Court, U.S.
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In The
Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo*, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings below were petitioners Linda Lingle, the Governor of Hawaii, and Mark J. Bennett, the Attorney General of Hawaii, and respondent Chevron USA, Inc. Pursuant to Fed. R. App. P. 43(c)(2), Linda Lingle was substituted below for her predecessor as Governor, Benjamin J. Cayetano, and Mark J. Bennett was substituted below for his predecessors as Attorney General, Earl I. Anzai and Margery S. Bronster. (The opinion of the Ninth Circuit issued on April 1, 2004 erroneously listed former Attorney General Bronster as a defendant and misspelled Attorney General Bennett's name; the court amended its opinion on April 15, 2004 to correct the caption. The amended opinion is reprinted in the appendix hereto.)

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OPINIONS BELOW

The Ninth Circuit's opinion (App. 1) is reported at 363 F.3d 846. The District Court's opinion (App. 30) is reported at 198 F.Supp.2d 1182. The Ninth Circuit's earlier decision reversing summary judgment and remanding for trial (App. 54) is reported at 224 F.3d 1030. The District Court's initial decision (App. 94) is reported at 57 F.Supp.2d 1003.

JURISDICTION

The Ninth Circuit entered its judgment on April 1, 2004. On June 21, 2004, Justice O'Connor extended petitioners' time to file a petition for *certiorari* to July 30, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED

The Fifth Amendment to the Constitution provides in relevant part: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." The Fourteenth Amendment provides, in Section 1: "No state shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." The relevant portions of Act 257, Haw. Rev. Stat. § 486H-10.4 (1997), are reprinted at App. 121.

STATEMENT OF THE CASE

1. The State of Hawaii is "physically small and geographically remote." Act 257, § 1(4). As a result, its economy is unusually subject to risk of oligopolistic concentration. This risk is particularly evident in the market for oil products in the state. Hawaii is served by only two refiners, and the wholesale market for gasoline on Oahu,

the state's most populous island, is divided among only six companies. The retail market for gasoline is protected from similar high concentration, however, by the presence of numerous gas station operators who lease stations from oil companies and set pump prices independently.

To maintain the benefit for consumers of a multiplicity of independent lessee-dealerships, the Hawaii legislature enacted Act 257. The Act prohibits oil companies from converting lessee-dealer stations to company-operated stations, and from locating new company-operated stations in proximity to existing lessee-dealer stations. In addition, to prevent oil companies from increasing rents to drive independent dealers out of business, § 3(c) of the Act limits the maximum rent that oil companies may charge dealers. Although Act 257 employs rent regulation to achieve its goals, it was not enacted primarily for the benefit of dealers paying rent (in contrast to, for example, an apartment rent control measure intended primarily for the benefit of rent-paying tenants). Rather, the Act is intended to stabilize the present structure of the retail market for gasoline, preserving the long-term benefit for consumers of multiple retail vendors and averting the economic harm that would occur if the retail market, like the wholesale market, were to become concentrated in the hands of the few oil companies serving the islands.[1]

2. Chevron USA, Inc., the largest refiner and marketer of gasoline in Hawaii, sued the Governor and Attorney General of Hawaii, claiming that the rent cap imposed by Act 257 on its face effects an unconstitutional taking of Chevron's property and violates due process and equal

[1] Although the purpose of the Act is plainly prophylactic, the Ninth Circuit misapprehended this point. The Ninth Circuit characterized the purpose of the law as "lowering retail gas prices," App. 18, erroneously implying that the Act was intended to *reduce* prices for gasoline from current levels rather than to ward against potential *increases* in such prices if lessee-dealers were driven from the marketplace.

protection. Chevron sought declaratory and injunctive relief, but did not request compensation. Chevron subsequently stipulated that, including its earnings from the sale of gasoline, "Chevron has earned in the past and anticipates that it will earn in the future, at the rent levels allowed by Act 257, a return that satisfies any Constitutional standards on its investment in lessee dealer stations in Hawaii." C.A. Excerpts of Rec. ("ER") 60.[2]

In 1998, the District Court granted Chevron summary judgment on its claim that § 3(c) of Act 257 effects a taking. The court rejected the State's argument that it should employ the deferential standard traditionally applied in the review of economic legislation under the Due Process Clause. Relying on language in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), the court held that the rent cap in Act 257 "does not substantially advance legitimate state interests," and enjoined the State from enforcing § 3(c) of the Act. App. 118. Chevron then voluntarily dismissed its due process and equal protection claims without prejudice.

3. On appeal, the Ninth Circuit held that the District Court had applied a correct standard of review under the Just Compensation Clause, but vacated the grant of summary judgment and remanded for trial. The court read a previous circuit decision, *Richardson v. City and County of Honolulu*, 124 F.3d 1150 (9th Cir. 1997), to foreclose the State's argument that a deferential, rational-basis standard of review should apply. Rather, the court stated that "a challenged regulatory action 'substantially advances' its interest if it bears a reasonable relationship to that interest," and concluded that "[w]hether Act 257's rent cap is reasonably related to its objective of lowering fuel prices

[2] Chevron also stipulated that the cap on permissible rent established by Act 257 was *higher* than the rent that it would otherwise have charged for 53 of the company's 64 lessee-dealer stations, and that Act 257 allows Chevron to recover more rent in aggregate from its lessee-dealer stations than it would otherwise charge. ER 56-57, 66-68.

certainly depends on whether it will in fact lead to lower fuel prices." App. 76. Finding that the affidavits before the trial court did not resolve that question, the Court of Appeals directed the District Court on remand to use trial procedures, including assessment of the credibility of the parties' expert witnesses through cross-examination, to determine as a matter of "predictive fact" whether the statute will achieve its goals. App. 69-72.

Judge William Fletcher concurred in the Ninth Circuit's disposition, but disagreed with the majority's analysis. App. 79-93. Judge Fletcher contended that this Court's precedents require that rent controls and other price controls be evaluated under a deferential standard of review, rather than the heightened "substantially advance" standard employed by the majority.

4. On remand, the District Court held a one-day evidentiary hearing at which the parties each presented a single expert economist to give his opinion on the effectiveness of Act 257's rent cap in protecting Hawaii's consumers. Chevron's expert argued that dealers will be able to capture a premium reflecting the economic benefit of the rent cap if they sublease their stations to new dealers, making the law ineffectual to the extent it aimed at lowering dealer costs. He also opined that oil companies will try to recoup at least part of any lost rent by increasing the wholesale gasoline prices charged to their dealers, undermining the goal of controlling gasoline prices. Finally, Chevron's expert argued that the rent cap will discourage oil companies from investing in new lessee-dealer stations, leading over time to fewer such stations. ER 105-110. Chevron's expert did not deny, however, that the law would prevent oil companies from using rent increases to displace lessee-dealers.

The State's expert testified that, by helping to maintain the existence of lessee-dealers as independent price-setters, Act 257 protected Hawaii's consumers from the economic harm that would result if the retail gasoline

market were controlled directly by the few oil companies serving the state. He testified that the legislation would achieve this goal whether or not existing dealers could capture a premium upon subleasing, because the rent cap would in any case preclude the oil companies from raising rents to the point of driving dealers out of business. He contested Chevron's contention that the oil companies would rationally attempt to raise wholesale prices, noting that such a strategy would lead to reduced sales volume and net revenues. He also disputed Chevron's suggestion that the rent cap would deter the oil companies from investing in new lessee-dealer stations, pointing out that the oil companies were not building such stations anyway, and opined that consumers would benefit as long as some number of lessee-dealers remained in the retail market. ER 135-142.

Finding the economic theories presented by Chevron's expert "more persuasive" than those of the State's expert, App. 43, the District Court concluded that Act 257 does not substantially advance a legitimate state interest and therefore effects a taking of Chevron's property. App. 53. The District Court acknowledged that the rent cap would prevent oil companies from raising rents to levels designed to drive lessee-dealers out of business, but it discounted this justification for the Act because it did not believe that oil companies would attempt such constructive eviction.[3] App. 48, 52.

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[3] The District Court overlooked testimony that oil companies found company-operated stations more profitable than leased stations, as well as the testimony of Chevron's own expert that he had served as an expert for oil companies in many cases where dealers alleged that the oil companies had raised their rents in order to drive them out of business. ER 154-58, 163-65. Congress has repeatedly recognized the anticompetitive practices of the oil industry toward independent retailers. *See, e.g.*, S. REP. NO. 102-450, at 3-4, 6 (1992) (noting oil companies' use of "massive rent increase[s] . . . that would assure the economic eviction of the dealer"). Congress enacted the Petroleum

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5. On appeal once more to the Ninth Circuit, the State argued that Chevron's claim that Act 257 does not "substantially advance a legitimate state interest" properly lies under the Due Process Clause, rather than the Just Compensation Clause. The State also argued that the District Court should have deferred to the rational economic judgment of the legislature that the rent cap would benefit consumers. The Court of Appeals held that these arguments were barred by law of the case established in its previous decision. With respect to the State's argument that challenges to the rationality of legislation properly belong under the Due Process Clause, the Court of Appeals remarked that the "varying opinions" of the Supreme Court "suggest confusion over the relationship between due process and takings claims." App. 10. The Court of Appeals nonetheless concluded that this Court had not clearly repudiated the "substantially advance" takings formulation, and held that the panel's prior decision resolving this issue was not clearly erroneous. App. 11-13. The Court of Appeals also concluded that this Court's decisions require a heightened, "intermediate" standard of review for claims under the Just Compensation Clause that laws do not substantially advance legitimate state interests. App. 14-17. The Court of Appeals did not consider whether the statute would be sustained under a deferential standard.[4]

Marketing Practices Act, 15 U.S.C. §§ 2801-2806, to restrain oil companies from replacing lessee dealers with company-owned stations. The federal statute does not directly restrain rents charged by oil companies, however, as Act 257 does.

[4] The State also pointed out that the District Court found that Act 257 would prevent constructive eviction of the lessee-dealers in Hawaii. This finding, the State argued, establishes that the law in fact substantially advances the State's goals. The Ninth Circuit rejected that argument, stating that the State "does not challenge the district court's conclusion of law that Act 257 fails to advance Hawaii's goal of lowering retail gas prices," but "focuses instead on whether Act 257 advances

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Judge Fletcher dissented, repeating his view that the "substantially advance" takings test was incorrectly applied to the rent cap imposed by Act 257:

> We took a wrong turn in *Richardson*, we continued on the wrong path in *Chevron I*, and we are now in the wrong place. Under the panel's holding, virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and many of those laws may well be held unconstitutional under that test. Rent control is often inefficient and sometimes unfair. But we should not confuse inefficiency and unfairness with unconstitutionality.

App. 29 (internal quotes and citations omitted).

REASONS FOR GRANTING THE PETITION

The Ninth Circuit's decision in this case raises two closely related issues of constitutional law that call out for

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another purported purpose," namely, maintaining the existence of an independent body of gas station operators "for their own sake." App. 18. These remarks by the Ninth Circuit misstate the State's position. First, although the State did not dispute whether the statute would directly reduce *current* gasoline prices, it squarely challenged the District Court's conclusion of law that the statute did not substantially advance the State's goals of protecting consumers. The State argued that by maintaining the viability of lessee-dealers, the Act will avert *future* harm, in the form of increased gasoline prices, that would result if independent retail gasoline vendors were eliminated. Second, the State never suggested that maintenance of the lessee-dealers was an end in itself; Hawaii's position has always been that Act 257 seeks to maintain the viability of independent lessee-dealers *as an essential means* to avoid the economic harm of oligopolistic concentration in the retail market for gasoline. This understanding of the Act is supported by its numerous provisions aimed at protecting lessee-dealers from economic pressure from the oil companies and by its legislative history, which confirms the legislature's intention to "provide certain protection for dealer operated retail service stations." Conference Comm. Rep. No. 38, reprinted at App. 124.

resolution by this Court. Both questions implicate fundamental concerns about the proper balance between the judiciary and institutions of democratic governance, and between the national government and the states within our federal system. The first question is whether challenges to a law's substantive validity – that is, the law's reasonableness or efficacy in accomplishing the government's objectives – properly lie under the Just Compensation Clause at all. If so, the second question is whether courts should employ a deferential "rational-basis" standard of review for such challenges, as they unquestionably would if the same inquiry were undertaken under other constitutional rubrics, such as the Due Process Clause. This Court has recently identified the first question as an open, important issue, and there are conflicts as to both issues in the federal appellate courts and the highest courts of several states.[5] The Court should grant review of both questions to make clear that the Just Compensation Clause cannot be employed to second-guess the reasonableness of legislative policy judgments, but rather exists to ensure – as the text of the Clause makes clear – that, when the government does take private property for public use, it must pay compensation.

[5] At least ten other petitions for *certiorari* have been filed in the past several years requesting that the Court resolve either or both of these issues. In *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), the Court granted *certiorari* to resolve issues related to the application of the "substantially advance" test, but did not reach the validity of that test for procedural reasons. In *Yee v. City of Escondido*, 503 U.S. 519 (1992), the Court declined to consider the validity of a regulatory taking claim based on the "substantially advance" theory because the issue was not fairly included within the Court's grant of *certiorari*.

I. Whether The Just Compensation Clause Authorizes Judicial Scrutiny Of The Reasonableness Or Efficacy Of Legislation Is An Open Question In This Court, And Is An Issue Of Fundamental Importance On Which Lower Courts Are In Conflict

A. This Court Has Noted The Uncertainty As To Whether A Regulation May Be Deemed A "Taking" Solely Because It Does Not Substantially Advance A Governmental Interest

Every Justice of this Court has recently authored or joined in opinions acknowledging that it is at least an open question whether a law may be challenged as an unconstitutional "taking" on the ground that it does not substantially advance a governmental interest. Moreover, five Justices have endorsed the view that such a challenge does not lie under the Just Compensation Clause at all.

In *Agins*, this Court stated that a regulation may effect a taking "if the ordinance does not substantially advance legitimate state interests." 447 U.S. at 260. For that proposition, *Agins* cited and discussed only due process decisions, *Nectow v. City of Cambridge*, 277 U.S. 183, 188 (1928), and *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).[6] The Court in *Agins* did not articulate in detail the nature of the legal inquiry intended by that language, or the relevance of the rationality of government action to a claim brought under the Just Compensation Clause. Outside the special context of exactions of real property, the Court has never squarely relied upon the

[6] In *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 127 (1978), the Court similarly relied upon due process case law, including *Nectow* and *Euclid*, in suggesting in *dictum* that a regulation "may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose."

Agins means-ends test to invalidate a government regulation under that Clause.

In *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), five Justices directly challenged the validity of the *Agins* language as a test for the existence of an unconstitutional "taking." Justice Kennedy, concurring in the judgment, observed that the *Agins* formulation, calling for "normative consideration[] about the wisdom of government decisions," is in "uneasy tension with our basic understanding of the Takings Clause":

> As its language indicates, and as the Court has frequently noted, [the Takings Clause] does not prohibit the taking of private property, but instead places a condition on the exercise of that power. This basic understanding of the Amendment makes clear that it is designed not to limit the governmental interference with property rights per se, but rather to secure compensation in the event of otherwise proper interference amounting to a taking.

Id. at 545 (quoting *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 314-15 (1987)) (internal quotation marks omitted). He concluded: "Given that the constitutionality of the [statute] appears to turn on the legitimacy of Congress' judgment rather than on the availability of compensation ... the more appropriate constitutional analysis arises under general due process principles rather than under the Takings Clause." *Id.* Justice Breyer, writing for four dissenting Justices, agreed that inquiry into the legitimacy of government action is inappropriate under the Just Compensation Clause: "[A]t the heart of the Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for *legitimate* government action that takes 'private property' to serve the 'public' good." *Id.* at 554 (second emphasis added). Even if these congruent conclusions from five Justices do not technically constitute a holding rejecting the *Agins* formulation,

Eastern Enterprises clearly indicates that a majority of the Court doubts the validity of that test.

In *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), the Court reviewed an application of the "substantially advance" test, but declined to resolve the validity of this ostensible takings test since the city itself drafted the jury instructions incorporating that standard. However, the Court acknowledged that, outside the special context of exactions, it has never provided a "thorough explanation of the nature *or applicability* of the requirement that a regulation substantially advance legitimate public interests." *Id.* at 704 (emphasis added). In separate opinions, five Justices expressly reserved the question whether the "substantially advance" formulation represents a valid test under the Just Compensation Clause. *Id.* at 732 n.2 (Scalia, J., concurring) ("As the Court explains, petitioner forfeited any objection to this standard, ... and I express no view as to its propriety."); *id.* at 753 n.12 (Souter, J., dissenting) ("I offer no opinion here on whether *Agins* was correct in assuming that this prong of liability was properly cognizable as flowing from the Just Compensation Clause of the Fifth Amendment, as distinct from the Due Process Clauses of the Fifth and Fourteenth Amendments.").

The Court's earlier decisions in *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), and *Dolan v. City of Tigard*, 512 U.S. 374 (1994), did invoke the "substantially advance" formulation to address the special problems posed by permit conditions mandating public access to private property. The Court has made clear, however, that the rules developed in those cases, requiring that such exactions have an "essential nexus" with and be "roughly proportional" to the government's concerns, do not apply more broadly to denials of permits or other regulatory actions. *See Del Monte Dunes*, 526 U.S. at 703. Nor do those standards apply to general legislation. *See Dolan*, 512 U.S. at 391 n.8. This Court's invocation of the

Agins formulation in *Nollan* and *Dolan* in no way diminishes the Court's recognition in subsequent decisions that its validity as a general test for regulatory takings represents an important, unresolved issue.

B. Whether The Just Compensation Clause Authorizes Judicial Review Of The Rationality Of State Legislation Is A Question Of Fundamental Importance

The Ninth Circuit's view that a statute may be enjoined as an unconstitutional "taking" on the ground that it fails to advance legitimate government interests, if allowed to stand, would effect a dramatic change in takings jurisprudence. The Ninth Circuit's position is contrary to this Court's long-settled understanding that the purpose of the Just Compensation Clause is to ensure compensation for appropriations of property and regulations of equivalent severity, not to act as a substantive check on the government action in the first instance. As this Court said in *First English*, "[t]his basic understanding of the [Clause] makes clear that it is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of *otherwise proper* interference amounting to a taking." 482 U.S. at 314 (second emphasis added). Apart from the special context of exactions, this Court has never deviated from that "basic understanding" of the Just Compensation Clause.[7]

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[7] Numerous commentators have argued that it is anomalous to test the validity of legislation under the Just Compensation Clause. *See, e.g.*, Frank Michelman, *The Jurisprudence of Takings*, 88 COLUM. L. REV. 1600, 1605-14 (1987); Jerold Kayden, *Land-Use Regulations, Rationality, and Judicial Review: The RSVP in the* Nollan *Invitation*, 23 URB. LAW. 301 (1991); Thomas E. Roberts, Karen Edginton Milner, Robert I. McMurry, *Land-Use Litigation: Doctrinal Confusion Under the Fifth and Fourteenth Amendments*, 28 URB. LAW. 765, 769-70 (1996).

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This Court's regulatory takings jurisprudence thus presupposes that a government regulation serves a valid public purpose. *E.g., Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922) ("The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides it shall not be taken for such use without compensation"). Indeed, a government action *must* serve a valid public use if it is to be treated as a taking that would require compensation. In *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406, 1417 (2003), for example, the Court stated that the precondition for any exercise of the government's taking power is that the government action serve a "public use," which the Court equated to a requirement of "legitimacy" of the government action. *See also Palazzolo v. Rhode Island*, 533 U.S. 606, 635 n.* (O'Connor., J., concurring) (question whether regulation serves a valid public use is distinct from the question of whether a regulation effects a compensable taking). The Ninth Circuit's embrace of the "substantially advance" test, however, leads to the untenable position that the substantive *legitimacy* of government action is a prerequisite for a valid takings claim *and* that substantive *illegitimacy* provides an independent basis for establishing a taking. Both of these propositions cannot be correct. Because the Ninth Circuit apparently believed itself compelled by language in this Court's decision in *Agins* to produce this strange result, this Court's review is necessary to resolve this confusion.

The Ninth Circuit's approach is particularly incongruous where, as here, it is stipulated that the government

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Academic critics of the Court's *Agins* formulation include prominent scholars who generally argue for a broad reading of the Just Compensation Clause. *See, e.g.*, John E. Fee, *The Takings Clause as a Comparative Right*, 76 S. CAL. L. REV. 1003, 1035-36 (2003); Steven J. Eagle, *Substantive Due Process and Regulatory Takings: A Reappraisal*, 51 ALA. L. REV. 977, 978 (2000).

regulation will not have any significant adverse economic effect on the property owner. *See* p. 3, *supra*. This Court's regulatory takings jurisprudence focuses primarily if not exclusively on whether the economic burden imposed by government action "goes too far," *Mahon*, 260 U.S. at 415, such that the government may proceed if, but only if, it pays compensation. A regulatory taking is understood to be the equivalent of a physical appropriation precisely because of the severity of the economic impact that it works upon the property owner. *See Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *Penn Central*, 438 U.S. at 124. Under the Ninth Circuit's mistaken view, however, a law may be invalidated as a regulatory taking merely because a court deems it ineffective, even if its economic impact is slight (or nonexistent).

This Court's settled understanding that the Just Compensation Clause affords compensation for economically onerous government action affecting property interests – not a mechanism for substantive judicial review of the efficacy or wisdom of the government action – also explains why this Court has consistently stated that (with narrow exceptions), the ordinary remedy for a violation of the Just Compensation Clause is just compensation, not invalidation of a government regulation. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1016 (1984) ("Equitable relief is not available to enjoin an alleged taking of private property for public use"). By contrast, the Ninth Circuit has ruled that the appropriate remedy for a taking under the "substantially advance" theory is an injunction rather than compensation, because the premise of such a claim is that the government lacks the authority to act. *Daniel v. County of Santa Barbara*, 288 F.3d 375, 384-85 (9th Cir. 2002). The Ninth Circuit's novel injunctive remedy for a taking under the substantially advance test is inconsistent

with *Ruckelshaus*, providing another reason for the Court to grant review in this case.[8]

More fundamentally, as the State explains in greater detail in Part II, *infra*, the Ninth Circuit's improper incorporation of substantive due process analysis into takings doctrine has provided a pretext for that court's improper judicial invalidation of state legislation based on an intrusive standard of review of economic legislation not seen since the days of *Lochner v. New York*, 198 U.S. 45 (1905). It has long been settled that, under the Due Process Clause, the courts owe the legislature great deference in reviewing the wisdom and effectiveness of economic legislation. *See Williamson v. Lee Optical Co.*, 348 U.S. 483, 488 (1955). Yet now the Ninth Circuit has adopted, without any real explanation or justification, the position that the courts may and should engage in intrusive means-ends review of economic legislation under the Just Compensation Clause that would be obviously and completely out of bounds if the claim were brought under the Due Process Clause.[9] That position cannot be sustained

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[8] Consistent with the view that injunctive relief is an appropriate remedy under this takings theory, the Ninth Circuit has also ruled that a claimant raising a "substantially advance" taking claim may file suit immediately in federal court and has no obligation to exhaust available state compensation procedures in compliance with *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985). *See, e.g., Daniel, supra*, 288 F.3d at 385. The ability of takings claimants invoking this theory to avoid state exhaustion requirements, combined with the heightened level of scrutiny under Ninth Circuit precedents, means that litigants challenging state and local regulations will routinely file in federal rather than state court. Thus, the issue raised by this case has significant implications for forum shopping between the federal and state courts, as well as for the potential burdens such claims may impose on federal courts.

[9] There is no theory that justifies transplanting due process analysis into takings soil. To the contrary, given the differences in language between the Just Compensation and Due Process Clauses, it is more logical to conclude that these two provisions provide different rather than overlapping types of protections for private property

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under the Court's long-settled understanding of the Just Compensation Clause.

C. The Lower Courts Have Reached Conflicting Conclusions About The Proper Role Of The Just Compensation Clause In Judicial Review Of Government Action

In the absence of definitive guidance from this Court about the proper role of the Just Compensation Clause in challenges to the substantive validity of government action, lower appellate courts (both state and federal) have reached widely divergent conclusions, including many decisions in conflict with the decision below in this case. The Ninth Circuit's decision conflicts directly with state supreme court decisions holding that challenges to the rationality of government regulation must be brought under the Due Process Clause, not the Just Compensation Clause. *See Brunelle v. Town of South Kingston*, 700 A.2d 1075, 1083-84 n.5 (R.I. 1997) ("[T]he arbitrariness or capriciousness of a particular state action is properly examined under the light of the Fourteenth Amendment due process clause and not the Fifth Amendment takings clause."); *Mission Springs Inc. v City of Spokane*, 954 P.2d 250, 258 (Wash. 1998) (claim of arbitrary action by municipality in withholding building permit was not "appropriative governmental action" within the scope of Just Compensation Clause). The Ninth Circuit's decision also conflicts with state supreme court decisions holding that a taking claim must be based on economic harm to affected property interests, and may not be predicated simply on the application of an invalid regulation. *See Tampa-Hillsborough County Expressway Authority v. A.G.W.S.*

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interests. *See Harmelin v. Michigan*, 501 U.S. 957, 978 n.9 (1991) ("When two parts of a [single constitutional amendment] use different language to address the same or similar subject matter, a difference in meaning is assumed.").

Corp., 640 So.2d 54, 56-58 (Fla. 1994) (clarifying that a prior decision invalidating a statutory mechanism for land use planning was based upon due process principles, out of concern that claimants would seek unfair windfalls under the Just Compensation Clause by arguing that ordinance failed to advance a legitimate state interest); *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334, 343-46 (N.J. 2001) (application of an invalid ordinance to plaintiff's property is not the "'otherwise proper [governmental] interference' that the Takings Clause presupposes").[10]

The Ninth Circuit's decision also conflicts with decisions of other federal circuits. *Simi Investment Co. v. Harris County*, 256 F.3d 323 & n.3 (5th Cir. 2001) (although the Just Compensation Clause covers many landowner complaints about intrusions on property rights, challenges to government action as "illegitimate and arbitrary" lie under the Due Process Clause); *Restigouche, Inc. v. Town of Jupiter*, 59 F.3d 1208, 1211 n.1 (11th Cir. 1995) (the Eleventh Circuit "does not recognize [substantially advance takings claims] as distinct, viable federal constitutional claims in the zoning context"). The Ninth Circuit's decision also cannot be reconciled with decisions of the Federal Circuit holding that the legitimacy of the government's action is a *precondition* for a claim for just compensation against the United States. *See, e.g., Rith Energy, Inc. v. United States*, 270 F.3d 1347, 1352 (Fed. Cir. 2001); *Florida Rock Industries, Inc. v. United States*, 791 F.2d 893, 898-900 (Fed. Cir. 1986). The Court of Federal Claims, with jurisdiction over virtually all takings claims against the United States, has held that allegations

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[10] Other state courts, however, have endorsed the *Agins* formulation as a test for the substantive validity of a state law, reflecting the ambiguity of this Court's decisions. *See, e.g., Sheffield Development Co., Inc. v. City of Glenn Heights, Texas*, __ S.W.3d __, 2004 WL 422594 (Tex. 2004); *State ex rel. Shemo v. City of Mayfield Heights*, 765 N.E.2d 345 (Ohio 2002).

that a federal action does not substantially advance a legitimate interest do not state a claim under the Just Compensation Clause, but instead represent either a tort claim or a due process claim. *Bamber v. United States*, 45 Fed. Cl. 162, 165 (Fed. Cl. 1999). To the State's knowledge, no decision of the Court of Federal Claims or the Federal Circuit has ever found a taking based on the "substantially advance" test. *Cf. Seiber v. United States*, 364 F.3d 1356, 1367-68 (Fed. Cir. 2004) (noting uncertainty in the Supreme Court's decisions, but finding it unnecessary to decide whether *Agins* established a distinct takings test).

To compound the confusion, the Ninth Circuit itself, sitting *en banc*, has sharply questioned the propriety of reviewing the wisdom and efficacy of state legislation under the Just Compensation Clause. The Ninth Circuit relied on Justice Kennedy's concurring opinion in *Eastern Enterprises* in observing that the Clause "was never intended to replace the role of the people in determining which social programs are appropriate," and "'has not been understood to be a substantive or absolute limit on the government's power to act.'" *Washington Legal Foundation v. Legal Foundation of Washington*, 271 F.3d 835, 856 (9th Cir. 2001) (*en banc*) (quoting *Eastern Enterprises*, 524 U.S. at 545 (Kennedy, J., concurring in the judgment)), *aff'd sub nom. Brown v. Legal Foundation of Washington*, 123 S.Ct. 1406 (2003).[11]

[11] The Ninth Circuit has gone beyond embracing the "substantially advance" theory under the Just Compensation Clause to rule that property owners challenging property regulation as arbitrary or illegitimate in a constitutional sense *must* bring their claims under the Just Compensation Clause rather than the Due Process Clause. *See, e.g., Macri v. King County*, 126 F.3d 1125, 1129 (9th Cir. 1997). Thus, the Ninth Circuit has taken the position that what is really a due process claim not only *can* be brought under the Just Compensation Clause but *cannot* be brought under the Due Process Clause itself. The majority of other circuits have rejected this position. *See* Robert

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The widespread confusion has prompted calls for the Court to resolve the issue. In *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993 (Cal. 1999), Justice Kennard explicitly requested this Court to resolve the confusion sown by *Agins*:

> Outside the *Nollan/Dolan* context, should a means-ends test be used to determine whether a taking has occurred, or instead should means-ends testing remain within due process jurisprudence? Only the high court can resolve this question and, given the importance of this area of the law, I respectfully suggest that it do so when the opportunity next arises.

Id. at 1013 (Kennard, J., concurring). Justice Kennard's request was echoed by Justice Brown in dissent. *Id.* at 1047 (Brown, J., dissenting).

II. The Proper Standard Of Review Under The Just Compensation Clause For Challenges To Economic Legislation Is Also An Important Issue On Which Lower Courts Have Divided

A. The Proper Standard Of Review Is An Important Issue

The second issue presented by this case, assuming that means-ends analysis under the Just Compensation Clause is permissible at all, is what standard of review should govern application of this test. This too is an important issue warranting review in this Court because it raises fundamental questions concerning the proper

Ashbrook, *Land Development, the* Graham *Doctrine, and the Extinction of Economic Substantive Due Process*, 150 U. PA. L. REV. 1255 (2002). This additional conflict among the circuits would disappear if this Court were to rule, as the State submits it should, that challenges to the substantive validity of regulation do not belong under the Just Compensation Clause at all.

balance between the judiciary and institutions of democratic governance within our federal system. Since the 1930's, this Court has granted considerable deference to the judgments of legislatures about the need for, or wisdom of, economic regulation. As the Court observed in *Williamson v. Lee Optical*, "The day is gone when this Court uses the Due Process Clause . . . to strike down . . . laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought." 348 U.S. at 488. The Court has accordingly employed a rational-relationship test for Due Process and Equal Protection Clause challenges to economic laws, upholding legislation that a rational legislator could have believed would advance a permissible public purpose. *Id.* at 487-88. Property regulation, including rent control legislation, has long been considered the kind of economic regulation subject to invalidation only when "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt." *Pennell v. City of San Jose*, 485 U.S. 1, 11 (1988).

The reluctance of the courts to intrude upon the judgments of legislatures in enacting economic legislation, regardless of the constitutional label attached to the claim, is based on several bedrock principles. First, deferential judicial review reflects the principle that governmental economic policy should generally be determined by democratically elected representatives, rather than unelected judges. *See, e.g., Schweiker v. Wilson*, 450 U.S. 221, 230 (1981) ("[T]his Court properly exercises only a limited review power over Congress, the appropriate representative body through which the public makes democratic choices among alternative solutions to social and economic problems."). Judicial deference also reflects the limited institutional competence of the courts to make predictive judgments concerning the efficacy of economic regulation.

See, e.g., General Motors v. Tracy, 519 U.S. 278, 308-09 (1997) (the Supreme Court is "institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them"; it is consequently "ill-qualified" to develop constitutional doctrine based on such predictive judgments). Finally, within our federal system, deferential review by federal courts of the actions of state legislatures prevents concentration of power in federal hands and helps preserve the states as "laborator[ies]" with freedom to conduct "novel social and economic experiments." *New State Ice Co. v. Liebman*, 285 U.S. 262, 280 (1932) (Brandeis, J., dissenting).

The Ninth Circuit's decision jettisons these principles of deferential review, returning to the kind of close supervision of social and economic policymaking not seen since the end of the *Lochner* era. The Ninth Circuit held that Act 257 must "substantially advance" the public interest, that legislation "substantially advances" an interest if it "bears a reasonable relationship" to that interest, and that "[w]hether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on whether it will in fact lead to lower fuel prices." App. 76. This standard affords the judgment of the Hawaii legislature no deference at all. Instead, it instructs the trial court to void the statute if, based upon the court's independent evaluation of testimony about "predictive facts," the court concludes that the Act will not work.

The Ninth Circuit's approach dramatically undermines the protections that this Court has erected against improper judicial interference with legislative policymaking. It also wreaks havoc with constitutional jurisprudence by creating different standards of review for what are in substance identical claims under the Just Compensation and Due Process Clauses. Litigants in the Ninth Circuit, an area comprising one-third of the nation, can now evade the rational-basis scrutiny applicable to due process claims simply by reframing their challenges to economic

legislation as "substantially advance" claims under the Just Compensation Clause.

The potential for "substantially advance" claims under the Just Compensation Clause to sweep away settled principles of judicial review is dramatically illustrated by the contrast between the Ninth Circuit's decision and this Court's decision unanimously upholding a statute remarkably similar to Act 257 against arguments challenging its economic wisdom. In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), the Court reviewed due process and other challenges to a Maryland law prohibiting oil companies from operating their own stations within the state. The law was enacted to protect the retail market for gasoline following complaints that oil companies had favored their own stations during gasoline shortages. The oil companies contended that the law would be counterproductive, reducing the number of retail outlets for gasoline in the state and harming consumers. This Court responded in terms that could not be more starkly opposed to the review employed by the Ninth Circuit in this case:

> The evidence presented by the refiners may cast some doubt on the wisdom of the statute, but it is, by now, absolutely clear that the Due Process Clause does not empower the judiciary "to sit as a 'superlegislature to weigh the wisdom of legislation' . . . " *Ferguson v. Skrupa*, 372 U.S. 726, 731 [1963] . . . Appellants argue that [prohibiting company-operated gas stations] is irrational and that it will frustrate rather than further the State's desired goal of enhancing competition. But . . . *this argument rests simply on an evaluation of the economic wisdom of the statute, . . . and cannot override the State's authority "to legislate against what are found to be injurious practices in their internal commercial and business affairs. . . ." . . . Regardless of the ultimate economic efficacy of the statute, we have no hesitancy in concluding that it bears a reasonable relation to the State's*

> *legitimate purpose in controlling the gasoline retail market, and we therefore reject appellants' due process claim.*

Id. at 124-25 (emphasis added; citations omitted). If this claim were brought today before the Ninth Circuit as a takings claim, the State's "authority to legislate against . . . injurious practices" would be given no weight whatsoever, and the statute, like Act 257 in this case, could be struck down as unconstitutional simply because the trial judge rejected the economic theory on which it was based. This Court should grant review to make clear that lower federal courts may not exercise such supervisory power over the merits of state legislation, whether challenged under the Just Compensation Clause or under the Due Process Clause.

B. The Ninth Circuit's Adoption Of A *De Novo* Standard Of Review Conflicts With This Court's Precedents

The intrusive standard of review adopted by the Ninth Circuit cannot be reconciled with this Court's takings decisions. Given the Court's uncertainty concerning the validity of the "substantially advance" formulation, it is not surprising that the Court has spoken only briefly to the standard of review that would govern application of this ostensible test. To the extent the Court has spoken to the issue, however, the Court has clearly ruled that a deferential standard of review must apply, and that the "substantially advance" test cannot be viewed as a judicial license to second-guess the legislature's judgment about the wisdom or effectiveness of a legislative measure.

Agins itself strongly suggests that the Court employed a deferential standard of review. The due process precedents upon which the *Agins* Court relied clearly employed

a highly deferential standard.[12] The *Agins* Court upheld a zoning ordinance as furthering "governmental purposes long . . . recognized as legitimate," 447 U.S. at 261, without any inquiry into whether the ordinance would actually achieve such goals. One year after *Agins,* the Court described the standard in that case in terms indistinguishable from the standard generally applied to government regulation under principles of due process. *Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 68 (1981) ("Where property interests are adversely affected by zoning, the courts generally have emphasized the breadth of municipal power to control land use and have sustained the regulation if it is *rationally related* to legitimate state concerns and does not deprive the owner of economically viable use of his property.") (citing *Agins, Village of Belle Terre,* and *Euclid*) (emphasis added).

The Court's decision in *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987), involving a claim that a Pennsylvania statute regulating mining failed to advance a legitimate purpose, also supports a deferential standard of review. To distinguish the statute at issue from the similar law held to be taking in *Mahon*, the majority in *Keystone* noted that the law reasonably served public purposes. 480 U.S. at 485-86. In dissent, then-Justice Rehnquist noted that it "may well be true" that the act under review better served a public purpose than its predecessor, but stressed that courts should not review the *efficacy* of state legislation in determining whether it

[12] *See Nectow*, 277 U.S. at 187-88 ("[A] court should not set aside the determination of public officers . . . unless it is clear that their action has no foundation in reason and is a mere arbitrary or irrational exercise of power having no substantial relation to the public health, the public morals, the public safety or the public welfare in its proper sense.") (internal quotes omitted); *Euclid*, 272 U.S. at 395 (to declare zoning ordinance unconstitutional, Court must find that provisions "are clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare.").

effects a "taking" requiring just compensation, just as they should defer to legislative judgments as to whether a law serves a "public use":

> [O]ur inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation. When considering the Fifth Amendment issues presented by Hawaii's Land Reform Act [in *Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229 (1984)] we noted that the Act, "like any other, may not be successful in achieving its intended goals. But 'whether *in fact* the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature *rationally could have believed* that the [Act] would promote its objective.'"

Id. (emphases and ellipses in original) (quoting *Midkiff*, 467 U.S. at 242).

In response, the majority agreed that a deferential standard of review should apply, invoking the Court's deferential due process jurisprudence:

> We do not suggest that courts have "a license to judge the effectiveness of legislation," . . . or that courts are to undertake "least restrictive alternative" analysis in deciding whether a state regulatory scheme is designed to remedy a public harm or is instead intended to provide private benefits. That a land use regulation may be somewhat overinclusive or underinclusive is, of course, no justification for rejecting it. *See Euclid v. Ambler Realty Co.* . . . .

Id. at 487 n.16.[13]

[13] The Ninth Circuit dismissed *Keystone*'s relevance, concluding that the Court's reference in that case to the deferential standard of review employed in *Midkiff* was irrelevant because *Midkiff* involved a formal exercise of eminent domain. App. 59. But *Keystone* itself involved a challenge to a regulation under the *Agins* "substantially advance" test, not an exercise of eminent domain.

The idea that a heightened standard of review should nonetheless apply to such claims seems to be attributable to an overly expansive reading of the Court's decision in *Nollan*. In that case, the Court addressed the special problem presented for courts reviewing requirements that landowners grant public access to their property in exchange for regulatory approval of specific development projects. Recognizing that physical occupations cannot ordinarily be forced upon landowners without compensation, the Court held that such exactions must show an "essential nexus" between the conditions imposed and the government's regulatory objectives. 483 U.S. at 837.

Responding to the dissent's concern that such heightened review was inconsistent with the rational-basis scrutiny generally applicable to economic regulations, *id.* at 842-48, the Court observed in a footnote that "there is no reason to believe (and the language of our cases gives some reason to disbelieve) that so long as the regulation of property is at issue the standards for takings challenges, due process challenges, and equal protection challenges are identical. . . ." *Id.* at 835 n.3. This statement is far from a holding that heightened scrutiny in fact applies to all regulatory takings claims, however. As the Court made clear in *Nollan* itself, its invocation of heightened scrutiny came in response to the unique problems posed by exactions:

> We are inclined to be particularly careful about the adjective ["substantial"] where the actual conveyance of property is made a condition to the lifting of a land-use restriction, since in that context there is heightened risk that the purpose is avoidance of the compensation requirement, rather than the stated police-power objective.

Id. at 841.

Subsequent decisions of the Court confirm this narrow reading of *Nollan*. In *Dolan*, the Court expanded upon the

rule established in *Nollan*, requiring that municipalities demonstrate that exactions are "roughly proportional" to a proposed development's impact. The Court emphasized, however, that this requirement applies only to *adjudicatory* decisions involving exactions of real property. *Id.* at 391 n.8. Where a party challenges *generally applicable* legislation, by contrast, "the burden properly rests on the party challenging the regulation to prove that it constitutes an arbitrary regulation of property rights." *Id.* This statement clearly indicates that a different, more deferential standard applies to general legislation than to exactions. Subsequently, in *Del Monte Dunes*, the Court made clear that the special rules applicable to exactions do not apply generally to regulatory takings claims. 526 U.S. at 703. While the specific holding in *Del Monte Dunes* was that the rough proportionality test cannot be applied outside the exactions context, it is implicit in the decision that the type of heightened review applied in *Dolan* and *Nollan* does not apply outside that context either.

The intrusive, *de novo* review applied by the Ninth Circuit in this case conflicts with the Court's unanimous teaching in *Keystone* that the Just Compensation Clause cannot be read as "a license to judge the effectiveness of legislation." This Court should grant review to reaffirm that a highly deferential standard of review governs constitutional challenges to economic legislation.

C. The Ninth Circuit's Application Of *De Novo* Review Conflicts With Decisions Of Another Federal Court Of Appeals And Several State Supreme Courts

The Ninth Circuit's application of heightened scrutiny conflicts with decisions of the First Circuit and the Supreme Courts of California and New York that interpret the *Agins* "substantially advance" formula as preserving traditional legislative discretion. In *South County Sand &*

Gravel Co., Inc. v. Town of South Kingston, 160 F.3d 834 (1st Cir. 1998), the First Circuit concluded that the distinction between the takings and due process modes of analysis "is . . . largely a matter of semantics," *id.* at 836, and held that the "substantial relation" and "rational basis" standards may be used "interchangeably" in reviewing a challenged zoning ordinance. *Id.* at 836 n.3. The court specifically declined to review the "effectiveness of municipal policy," a task the court concluded was "well outside our compass." *Id.* at 839.

In *Santa Monica Beach*, *supra*, the California Supreme Court affirmed the dismissal of a takings challenge to a city rent control law where the plaintiff wished to try to show that the law failed to achieve its goals. The court stated: "In sum, with rent control, as with most other such social and economic legislation, we leave to legislative bodies rather than the courts to evaluate whether the legislation has fallen so far short of its goals as to warrant repeal or amendment." 968 P.2d at 1007. The court also concluded in *Santa Monica Beach* that heightened scrutiny under this Court's *Nollan* and *Dolan* decisions did not apply to a legislative determination. *Id.* at 993. The California Supreme Court reaffirmed that conclusion in *San Remo Hotel v. San Francisco City and County*, 41 P.3d 87 (Cal. 2002), refusing to extend heightened scrutiny to legislation imposing fees on hotel conversions. The different standards applied by the Ninth Circuit and the California courts mean that challenges to state and local regulations in that state will be routinely brought in federal rather than state court.

Similarly, the New York Court of Appeals, in "easily" sustaining a town's zoning amendments, held that the *Agins* means-ends test only requires that land use laws bear a "reasonable relationship" to legitimate objectives, an approach indistinguishable from traditional due process analysis. *Bonnie Briar Syndicate v. Mamaroneck*, 721 N.E.2d 971 (N.Y. 1999). The New York Court of Appeals

rejected the argument that the "essential nexus" requirement of *Nollan* was generally applicable to regulatory takings claims, and refused to evaluate the "general wisdom or desirability" of the challenged regulation. *Id.* at 975-76.

III. This Case Presents A Compelling Opportunity For The Court To Resolve Both Of These Important Issues

Two important, related issues of takings law – whether the means-ends rationality of legislation may properly be reviewed under the Just Compensation Clause, and if so, whether a deferential standard of review must be employed – are squarely raised in this case. The facts clearly frame these questions for the Court's review. Chevron made no claim that it had suffered significant economic injury from the enactment of Act 257; it sought only to use the Just Compensation Clause to invalidate the statute because of disagreement with its economic policy, and did so in deliberate preference to seeking review of the law under due process and equal protection. The trial procedure employed to resolve Chevron's takings claim illuminates the inherent risk of intrusive judicial review posed by the *Agins* test as construed by the Ninth Circuit; the trial judge even tried to weigh the demeanor of the parties' expert witnesses as a factor in determining the constitutionality of the statute. App. 43.

The issues presented for review are not complicated by the presence of collateral issues or procedural defects (as was the case, for example, in *Del Monte Dunes*, where the Court was unable to reach the question of validity of the "substantially advance" test). The Ninth Circuit's decision represents a definitive and final determination of both questions. This case thus presents a narrowly focused

and compelling vehicle for this Court to resolve these important questions of constitutional doctrine.

CONCLUSION

For the reasons stated, the petition for certiorari should be granted.

Respectfully submitted,

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CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff-Appellee, v. LINDA LINGLE, Governor of the State of Hawaii; MARK J. BENNETT, Attorney General of the State of Hawaii, Defendants-Appellants.

No. 02-15867

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

363 F.3d 846; 2004 U.S. App. LEXIS 6091

November 10, 2003, Argued and Submitted, Honolulu, Hawaii
April 1, 2004, Filed

COUNSEL: Robert G. Dreher, Special Deputy Attorney General, Troutman Sanders LLP, Washington, D.C., for the defendants-appellants.

Craig E. Stewart, Pillsbury Winthrop LLP, San Francisco, California, for the plaintiff-appellee.

JUDGES: Before: Dorothy W. Nelson, Robert R. Beezer, and William A. Fletcher, Circuit Judges. Opinion by Judge Beezer; Dissent by Judge W. Fletcher.

OPINION BY: Robert R. Beezer

OPINION: BEEZER, Circuit Judge:

Hawaii Governor Linda Lingle ("Hawaii") appeals the district court's holding on remand that Section 3(c) of Act 257 of the 1997 Hawaii State Legislature ("Act 257" or "the Act") effects a regulatory taking in violation of the Takings Clause of the Fifth Amendment to the United States Constitution. Chevron USA, Inc. ("Chevron") challenged the Act, which, *inter alia,* proscribes the maximum

rent that oil companies can collect from dealers who lease company-owned service stations.

We have jurisdiction pursuant to 28 U.S.C. § 1331, and we affirm.

I

In response to concerns about the highly concentrated wholesale gasoline market in Hawaii and the resulting high cost of gasoline to consumers, the Hawaii Legislature enacted Act 257 in 1997. Act 257, among other things, regulates the maximum rent an oil company can charge dealers who lease its service stations. More specifically, Act 257 caps the rent that Chevron and other oil companies can collect from lessee-dealers at 15% of the dealer's profit on gasoline sales and 15% of the dealer's gross sales on products other than gasoline, plus a percentage increase equal to any increase the oil company may be required to pay on its ground lease.

Chevron is one of two gasoline refiners and one of six wholesalers in Hawaii. At the retail level, Chevron sells most of its gasoline through company-owned stations, which are leased to independent dealers. Chevron leases 64 service stations to dealers in Hawaii. From 1984 through the end of 1996, Chevron relied on estimated gasoline sales to calculate the rent owed by the lessee-dealers. After determining that the amount of gross rent receipts was not satisfactory, Chevron initiated a new nationwide dealer rental program in January 1997, restructuring the manner in which it calculated lease rates. This program, which the parties agree would be in effect in Hawaii but for Act 257, requires the lessee-dealer to pay a monthly rent, consisting of an escalating percentage of the

dealer's gross margin on actual, rather than estimated, gasoline sales. As noted, Act 257, in contrast, establishes a maximum regulated rent of 15% of gross margin.

Although Chevron maintains that Act 257 prevents it, through rental payments alone, from recovering its rental expenses, it concedes that over the past 20 years, Chevron has never fully recovered its expenses relating to dealer stations from rental income alone. Instead, Chevron relies on its supply contracts to earn a profit. Dealers who choose to rent a station from Chevron must as a condition of their lease agree to purchase from Chevron all the product necessary to satisfy demand at the station for Chevron gasoline. The price is unilaterally set by Chevron.

Both the lease agreement and supply contract permit the lessee-dealer to transfer his or her occupancy rights upon obtaining Chevron's written consent and paying a transfer fee set by Chevron. Act 257 does not prohibit such transfers, nor limit the price at which they can occur.

Chevron moved for partial summary judgment on its claim that Act 257 effects an unconstitutional regulatory taking because it fails to "substantially advance a legitimate state interest." Hawaii responded by filing a cross motion for summary judgment on all of Chevron's claims. The district court resolved the motions in Chevron's favor. *Chevron USA, Inc. v. Cayetano,* 57 F. Supp. 2d 1003, 1014 (D. Haw. 1998).

Hawaii appealed the district court's decision, challenging the standard used to evaluate Chevron's regulatory takings claim and the court's application of that standard. *Chevron USA, Inc. v. Cayetano,* 224 F.3d 1030, 1033 (9th Cir. 2000), *cert. denied,* 532 U.S. 942, 149 L. Ed. 2d 346, 121 S. Ct. 1403 (2001) (*"Chevron I"*). We held that the

district court applied the proper standard, relying primarily on the Supreme Court's opinion in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992), and our opinion in *Richardson v. City and County of Honolulu,* 124 F.3d 1150 (9th Cir. 1997), *cert. denied,* 525 U.S. 871, 142 L. Ed. 2d 137, 119 S. Ct. 168 (1998). *Id.* These cases teach that application of the "substantially advances" test is appropriate where a rent control ordinance creates the possibility that an incumbent lessee will be able to capture the value of the decreased rent in the form of a premium. We observed that genuine issues of material fact remained as to whether Act 257 failed to substantially advance its purpose of lowering retail gasoline prices, thus effecting a regulatory taking. *Id.* at 1042 ("[A] challenged regulatory action substantially advances its interest if it bears a reasonable relationship to that interest."). We vacated the district court's decision and remanded for "additional factual development and cross-examination of the parties' witnesses" on issues, including whether lessee-dealers will capture a premium based on the increased value of their leaseholds and whether oil companies will compensate for Act 257 by increasing wholesale prices. *Id.* at 1039, 1042.

In a petition for rehearing, Hawaii asserted for the first time that Chevron's challenge to Act 257 should be analyzed under the Due Process Clause, not the Takings Clause. We denied Hawaii's petition for rehearing; the Supreme Court subsequently denied Hawaii's petition for certiorari.

On remand, the district court considered the parties' stipulations of fact and the testimony of expert witnesses. The district court held that Act 257 was unconstitutional and issued written findings of fact and conclusions of law.

Chevron USA, Inc. v. Cayetano, 198 F. Supp. 2d 1182 (D. Haw. 2002). The court made a fact finding that rather than decreasing the retail price of gasoline in Hawaii, Act 257 would cause prices to increase. *Id.* at 1192.

On appeal, Hawaii argues that: (1) the district court should have analyzed Chevron's claim under the Due Process Clause rather than the Takings Clause; (2) the court misapplied the requirement that Act 257 "substantially advance a legitimate state interest"; and (3) even if the district court's application of the law was correct, it clearly erred in finding that Act 257 does not, in fact, substantially advance Hawaii's interest in reducing retail gasoline prices.

II

The first two of Hawaii's arguments are barred as law of the case. The law of the case doctrine provides that "the decision of an appellate court on a legal issue must be followed in all subsequent proceedings in the same case." *Bernhardt v. Los Angeles County,* 339 F.3d 920, 924 (9th Cir. 2003) (citation omitted). The doctrine applies to our "explicit decisions as well as those issues decided by necessary implication." *Id.* It is a discretionary doctrine with three recognized exceptions: (1) the earlier decision is clearly erroneous and its enforcement would work a manifest injustice;[1] (2) intervening controlling authority

[1] We have on separate occasions recognized two distinct formulations of this first exception. In *Jeffries v. Wood,* we stated that a panel may depart from law of the case if the previous decision "is clearly erroneous *and* its enforcement would work a manifest injustice." 114 F.3d 1484, 1489 (9th Cir.) (*en banc*) (emphasis added), *cert. denied,* 522

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makes reconsideration appropriate; or (3) substantially different evidence was adduced at a subsequent trial. *In re Rainbow Magazine, Inc.*, 77 F.3d 278, 281 (9th Cir. 1996). Only the first two exceptions potentially apply to Hawaii's arguments.

A. *Chevron I* Bars Hawaii's Argument that Chevron Must Challenge Act 257 Under the Due Process Clause

Hawaii first argues that Chevron's challenge to Hawaii's rent control ordinance properly lies under the Due Process Clause of the Fourteenth Amendment to the United States Constitution, not the Takings Clause of the Fifth Amendment. Hawaii maintains that claims challenging the validity of a government action based on its failure to "substantially advance a legitimate government interest" must be resolved using due process principles.

We explicitly addressed and rejected this argument when it was raised for the first time in Hawaii's petition for rehearing, and implicitly did so in *Chevron I* when we endorsed the "substantially advances" test over the more deferential test urged by Hawaii. *See* 224 F.3d at 1033, 1035. In its prior appeal, Hawaii maintained that the

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U.S. 1008, 139 L. Ed. 2d 423, 118 S. Ct. 586 (1997). In other cases, including some subsequent to *Jeffries*, we have stated the test in the disjunctive, allowing departure if the prior decision is clearly erroneous *or* would work a manifest injustice. *See, e.g., Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg. Planning Agency*, 216 F.3d 764, 787 n.3 (9th Cir. 2000) (citing cases), *aff'd*, 535 U.S. 302, 122 S. Ct. 1465, 152 L. Ed. 2d 517 (2002). We need not resolve this issue, however, because Hawaii is unable to satisfy either test.

appropriate inquiry was whether "the Legislature *rationally* could have believed the Act would substantially advance a legitimate purpose," the test typically applied to substantive due process challenges to economic legislation. *Id.* at 1033 (emphasis added). Our conclusion that this more deferential, due process standard does not apply to regulatory takings claims challenging land use regulations, including rent control ordinances like Act 257, logically stands as a rejection of Hawaii's current argument that such a challenge *must* be brought under the Due Process Clause. *See id.* at 1033, 1034 (explaining that in *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 242, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984), the Court applied the more deferential test only because it involved claims of an actual physical taking). This is also consistent with our opinion's refusal to accept the concurring opinion's argument that the Supreme Court established such a rule in *Pennell v. City of San Jose*, 485 U.S. 1, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988). *Id.* at 1034-35 (concluding that *Pennell* "did not . . . intimate in any way that rent control provisions should *only* be analyzed under the Due Process Clause. Rather, the Court determined that the Takings Clause claim was premature and then analyzed the Due Process Clause claim under the Due Process 'reasonableness' test") (emphasis added).

The law of the case doctrine therefore bars Hawaii's argument unless one of the recognized exceptions applies.

Hawaii relies primarily on the Supreme Court's opinion in *Eastern Enterprises v. Apfel*, 524 U.S. 498, 141 L. Ed. 2d 451, 118 S. Ct. 2131 (1998) to argue that our decision in *Chevron I* was clearly erroneous and will work a manifest injustice. In *Eastern Enterprises*, the Supreme Court holds that the Coal Industry Retiree Health Benefit

Act (the "Coal Act"), which requires coal operators to fund health benefits for retired employees and their dependents, is unconstitutional. 524 U.S. at 508 (plurality opinion). An operator challenges the law on both due process and takings grounds. *Id.* at 503-04. Four Justices conclude that the Coal Act violates the Takings Clause because it imposes severe, unanticipated retroactive liability on the operator and do not proceed to address the operator's due process claim. *Id.* at 528-29 (O'Connor, J., joined by Rehnquist, C.J., Scalia & Thomas, JJ.). Justice Kennedy concurs in the plurality's judgment but disagrees with the court's analysis; he concludes that the Coal Act violates the Due Process Clause, not the Takings Clause. *Id.* at 539-49 (Kennedy, J., concurring in the judgment, dissenting in part). The four remaining Justices dissent, concluding that the Act violates neither the Takings Clause nor the Due Process Clause. *Id.* at 551-53 (Stevens, J., dissenting, joined by Souter, Ginsberg & Breyer, JJ.), 553-68 (Breyer, J., dissenting, joined by, Stevens, Souter & Ginsberg, JJ.).

As an initial matter, *Eastern Enterprises* does not involve the type of regulatory takings claim at issue here. The Supreme Court applies the test set forth in *Penn Central Transportation Co. v. City of New York,* 438 U.S. 104, 57 L. Ed. 2d 631, 98 S. Ct. 2646 (1978), which focuses on the economic impact of a challenged law, not the "substantially advances" test. *Eastern Enterprises,* 524 U.S. at 529-37. Furthermore, the disagreement between the plurality and the other five Justices over whether the challenge to the Coal Act is properly viewed as a due process or takings claim focuses on the following limited question, inapplicable to this case: Whether a regulatory takings claim requires that the challenged regulation

affect a "specific property right or interest." 524 U.S. at 540, 541-47 (Kennedy, J., concurring in the judgment, dissenting in part) (observing that the Takings Clause is inappropriate because the Coal Act "does not operate upon or alter an identified property interest, and it is not applicable to or measured by a property interest"). The plurality endorses a more expansive view encompassing government regulations, like the Coal Act, that result in a "considerable financial burden," 524 U.S. at 529; the other five Justices would limit the regulatory takings doctrine to laws affecting a protected property interest. *Id.* at 540-47 (Kennedy, J., concurring in the judgment, dissenting in part); 554 (Breyer, J., dissenting).

Largely ignoring this issue, Hawaii relies in part on the following statement in Justice Kennedy's opinion to support its argument that a majority of the Supreme Court has repudiated "substantially advances" takings claims:

> The imprecision of our regulatory takings doctrine does open the door to normative considerations about the wisdom of government decisions. *See, e.g., Agins v. City of Tiburon* [cite omitted] (zoning constitutes a taking if it does not "substantially advance legitimate state interests"). This sort of analysis is in uneasy tension with our basic understanding of the Takings Clause, which has not been understood to be a substantive or absolute limit on the government's power to act.

524 U.S. at 545. Justice Kennedy's statement is in the context of a dispute over the proper scope of the regulatory takings doctrine. Indeed, it is immediately preceded by the

following: "If the plurality is adopting its novel and expansive concept of a taking in order to avoid making a normative judgment about the Coal Act, it fails in the attempt; for it must make the normative judgment in all events." *Id.* (citations omitted). Justice Kennedy is merely highlighting the already expansive and inconsistent nature of the Court's precedent. *See id.* at 545. Neither Justice Kennedy nor any of the other Justices expresses the opinion that takings claims based on the "substantially advances" theory are no longer valid.

The varying opinions in *Eastern Enterprises* suggest confusion over the relationship between due process and takings claims. They do not require us to abandon our holding in *Chevron I,* let alone render it clearly erroneous. *See, e.g., Assoc. of Bituminous Contractors, Inc. v. Apfel,* 332 U.S. App. D.C. 218, 156 F.3d 1246, 1254-55 (D.C. Cir. 1998) (concluding that the inability of a majority of the Court to agree on a single rationale for the result renders *Eastern Enterprises* of no precedential value outside of the specific facts of that case).[2]

[2] Hawaii cites to opinions of our sister circuits for the proposition that conclusions of the five-Justice majority in *Eastern Enterprises* are binding statements of law. Although this is true, the conclusion those courts are referring to is that a regulatory takings claim must involve a specific property interest. They do not purport to comment on the continued viability of "substantially advances" takings claims. *See, e.g., Commonwealth Edison Co. v. United States,* 271 F.3d 1327, 1339 (Fed. Cir. 2001) (*en banc*) ("Thus five justices . . . in *Eastern Enterprises* agreed that regulatory actions requiring the payment of money are not takings."), *cert. denied,* 535 U.S. 1096, 152 L. Ed. 2d 1051, 122 S. Ct. 2293 (2002); *Holland v. Big River Minerals Corp.,* 181 F.3d 597, 606 (4th Cir. 1999) (noting that the five Justices viewed the dispute under Due Process Clause rather than the Takings Clause "because no

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Supreme Court opinions filed after *Eastern Enterprises* do not stand as a repudiation of regulatory takings claims based on the "substantially advances" theory. *See Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency,* 535 U.S. 302, 152 L. Ed. 2d 517, 122 S. Ct. 1465 (2002); *City of Monterey v. Del Monte Dunes,* 526 U.S. 687, 143 L. Ed. 2d 882, 119 S. Ct. 1624 (1999). In *Del Monte Dunes,* the Supreme Court upholds a jury verdict against the City of Monterey on a regulatory takings claim that includes the theory that the city's repeated rejection of a development plan does not "substantially advance a legitimate government interest." 526 U.S. at 700-01, 721. The Court granted certiorari to address the question whether "the Court of Appeals impermissibly based its decision on a standard that allowed the jury to reweigh the reasonableness of the city's land use decision." *Id.* at 701. Although the Court does not directly address the propriety of the "substantially advances" test because the city failed to object to its inclusion in the court's jury instructions, *id.* at 704 (Scalia, J., concurring), the opinion of the Court states that "the trial court's instructions *are consistent with our previous general discussions of regulatory takings liability.*" *Id.* (emphasis added). In *Tahoe-Sierra Preservation Council, Inc.,* the Court addresses a regulatory takings claim brought by an association of landowners based on a planning agency's temporary moratorium on development. The Court limits its review to the theory argued by the association in the court of appeals but notes that "considerations of fairness and

identifiable property interest was infringed by the legislation"), *cert. denied,* 528 U.S. 1117, 145 L. Ed. 2d 814, 120 S. Ct. 936 (2000).

justice" could support a regulatory taking under several theories, including "that the moratoria *did not substantially advance a legitimate state interest.*" 535 U.S. at 334 (emphasis added). Although dicta, the statement clearly indicates that "substantially advances" claims remain viable under the Takings Clause.

Our opinions are consistent with Supreme Court teaching. The Takings Clause supercedes any substantive due process challenges when a law is challenged as a regulatory taking. *See Armendariz v. Penman,* 75 F.3d 1311, 1324 (9th Cir. 1996); *see also Esplanade Props., LLC v. City of Seattle,* 307 F.3d 978, 982 (9th Cir. 2002) (rejecting a claim that *Eastern Enterprises* overruled *Armendariz*); *Weinberg v. Whatcom County,* 241 F.3d 746, 749 n.1 (9th Cir. 2001) (applying *Armendariz*); *Buckles v. King County,* 191 F.3d 1127, 1137 (9th Cir. 1999) (same). We recently applied the "substantially advances" test to a regulatory takings claim in *Hotel & Motel Association of Oakland, et al. v. City of Oakland,* 344 F.3d 959, 965 (9th Cir. Sept. 17, 2003) (asking whether city maintenance and habitability requirements substantially advance a legitimate government interest).

Hawaii cites no case post-dating *Chevron I* that brings our use of the Takings Clause in that case into doubt. *See Rainbow Magazine, Inc.,* 77 F.3d at 281. To the contrary, subsequent opinions of the Supreme Court and this circuit support *Chevron I. See, e.g., Tahoe-Sierra Pres. Council, Inc.,* 535 U.S. at 334; *Esplanade Properties, LLC,* 307 F.3d at 982.

Hawaii's reliance on *Brown v. Legal Foundation of Washington,* 538 U.S. 216, 123 S. Ct. 1406, 155 L. Ed. 2d 376 (2003), which affirms *Washington Legal Foundation v.*

Legal Foundation of Washington, 271 F.3d 835 (9th Cir. 2001) (*en banc*), is misplaced. *Brown* involves, *inter alia,* the question whether a law requiring lawyers' client funds to be deposited into an interest bearing trust account is properly analyzed as a regulatory or *per se* taking. 123 S. Ct. at 1417-19; *see also Washington Legal Foundation,* 271 F.3d at 854-56. The Supreme Court has no reason to address regulatory takings based on a "substantially advances" theory or the question whether such claims should be brought under the Takings Clause or the Due Process Clause.

The law of the case doctrine now bars Hawaii's argument that Chevron's challenge properly lies under the Due Process Clause. We previously addressed Hawaii's argument in *Chevron I* and none of the exceptions to the doctrine are available to Hawaii.

B. *Chevron I* Bars Hawaii's Argument That Act 257 Should Be Reviewed Under a More Deferential Standard

Hawaii next argues that we erred in *Chevron I* by concluding that a given regulation "substantially advances" a legitimate state interest if it bears a "reasonable relationship" to that interest and by instructing that Chevron can establish the lack of such a relationship by showing, by a preponderance of the evidence, that the regulation will not in fact accomplish its stated purpose. Hawaii maintains that even if Chevron's challenge to Act 257 is viewed as a claim under the Takings Clause, the more deferential, rational basis test applied in due process cases is appropriate – *i.e.,* whether Hawaii *rationally could have believed* that Act 257 could have substantially advanced a legitimate government purpose. We explicitly

rejected these arguments as part of Hawaii's prior appeal, 224 F.3d at 1037; Hawaii has not justified departing from the law of the case.

In *Chevron I* we hold that the "substantially advances" test requires a "reasonable relationship" between a legitimate public purpose and the means used to effectuate that purpose. *Id.* at 1041 (citing and quoting from *Del Monte Dunes,* 526 U.S. at 700-01, 702-03). Our adoption of the "reasonable relationship," as well as the preponderance of the evidence standard, is based on the jury instructions the Supreme Court approves in *Del Monte Dunes.* 224 F.3d at 1041 (quoting instructions). This "reasonable relationship" test calls for an intermediate level of review, more stringent than the rational basis test used in the due process context, *see id.* at 1034 (distinguishing physical takings cases, which use a test drawn from due process), but less stringent than the "rough proportionality" test used in the context of exactions under the Takings Clause. *Id.* at 1041 (citing *Del Monte Dunes,* 526 U.S. at 703-04 as limiting the "rough proportionality" test to exaction context but commenting positively on jury instruction using "reasonable relationship" language); *see also Dolan v. City of Tigard,* 512 U.S. 374, 390, 129 L. Ed. 2d 304 (1994) (stating that the "reasonable relationship" test represents an intermediate level of scrutiny). Hawaii's argument that our decision in *Chevron I* is clearly erroneous is without merit.

The Supreme Court specifically rejects the standard proposed by Hawaii. *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987). *Nollan* is an exactions case in which the Court states that "[w]e have required that the regulation substantially advance the legitimate state interest sought to be achieved

[citing Agins], not that the State could rationally have decided that the measure adopted might achieve the State's objective." 483 U.S. at 825 n.3 (internal quotations omitted). In *Yee v. City of Escondido,* the Supreme Court suggests that this intermediate analysis is applicable to challenges involving rent control ordinances, like Hawaii's, that permit the capture of a premium. 503 U.S. 519, 530, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). Although the Court in *Yee* does not reach the regulatory takings issue because it is not properly presented for review, the Court does state that the possibility of a premium, "might have some bearing on whether the ordinance causes a regulatory taking" because it may shed light on whether there is a sufficient nexus between the desired ends and the means employed. *Id.* (citing *Nollan*). Relying on this language, we hold in *Richardson v. City and County of Honolulu* that land use regulations, including rent control ordinances that permit the capture of a premium, "[do] not effect a regulatory taking if [they] substantially further[ ] a legitimate state interest." 124 F.3d at 1164 (citing and quoting from *Yee*).

We explain in *Chevron I* that Hawaii's reliance on *Hawaii Housing Authority v. Midkiff,* 467 U.S. 229, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984) and *Keystone Bituminous Coal Ass'n v. De Benedictis,* 480 U.S. 470, 94 L. Ed. 2d 472, 107 S. Ct. 1232 (1987), as support for using the more deferential rational basis review, is misplaced. The Supreme Court reviews the challenged actions in those cases more deferentially because they involve physical takings. *Chevron I,* 224 F.3d at 1034 (observing that in the case of a physical taking the government "intends to take the property and is willing to pay compensation") (citing

Richardson, 124 F.3d at 1158). Hawaii presents no compelling reasons to rely on those opinions now. Moreover, Hawaii misses the fact that we incorporate this more deferential approach in the regulatory takings context when we review the state's "legitimate purpose"; the higher scrutiny is reserved for the means/ends fit.

Hawaii's argument that we apply a more deferential standard in *Commercial Builders of Northern California v. City of Sacramento,* 941 F.2d 872 (9th Cir. 1991), is also misplaced. In *Commercial Builders,* we apply the intermediate "rational relationship" test. *Id.* at 873. Our holding that a regulatory taking does not exist is based on evidence that "the Ordinance was implemented only after a detailed study revealed a *substantial connection between development and the problem to be addressed.*" *Id.* at 875 (emphasis added); *cf. id.* at 877 (Beezer, J., dissenting) ("Sacramento has commissioned a study that demonstrates at best a tenuous and theoretical connection between commercial development and housing needs."). Plaintiffs in *Commercial Builders* were unable to "rebut the Keyser-Marston conclusion that commercial development is related to an increase in the need for low-income housing." *Id.* at 876. In contrast, we held Chevron's claim fit for trial because the plaintiff on summary judgment adduced some evidence rebutting the state's evidence and conclusions. The question now is whether that evidence is sufficient to justify the trial court's judgment in this case. Hawaii fails to establish that our application of the "reasonable relationship" test or the preponderance of the evidence standard constitutes clear error.

Hawaii also fails to point to any intervening authority that prohibits *Chevron I's* use of the "reasonable relationship" test or preponderance of the evidence standard. The law of the case doctrine bars Hawaii's arguments.[3]

III

Hawaii argues that even if the district court applied the correct legal standard, it erred in concluding that Act 257 does not in fact substantially advance a legitimate state interest. The district court on remand heard testimony from Dr. John R. Umbeck, on behalf of Chevron, and Dr. Keith Leffler, on behalf of Hawaii. Based on their testimony, the court made the following relevant findings of fact: (1) oil companies will raise wholesale prices to offset any decrease in rent imposed by Act 257, thereby causing an *increase* in retail prices, *Chevron USA, Inc.,* 198 F. Supp. 2d at 1187; (2) a preponderance of the evidence establishes that Act 257 will enable lessee-dealers to sell their leaseholds at a premium, *id.* at 1189-90; (3) instead of decreasing retail gasoline prices by maintaining the presence of lessee-dealers in the market, Act 257 will *increase* gasoline prices by reducing the number of lessee-dealers, *id.* at 1190-91. Based on these findings, the district court concluded that Act 257 does not substantially advance a legitimate state interest. *Id.* at 1192.

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[3] Because Hawaii's arguments are barred by the law of the case doctrine, we need not address whether the State is also barred by the law of the circuit doctrine and whether, if they are, the latter should supplant the former. *See Jeffries,* 114 F.3d at 1511 n.16 (Kosinski, J., dissenting).

We review the district court's findings of fact for clear error. *Stratosphere Litigation LLC v. Grand Casinos, Inc.*, 298 F.3d 1137, 1142 (9th Cir. 2002). We review the district court's conclusions of law *de novo*. *Id.*

Hawaii does not challenge the district court's conclusion of law that Act 257 fails to advance Hawaii's goal of lowering retail gas prices, *see Chevron USA, Inc.*, 198 F. Supp. 2d at 1189, 1192-93; it focuses instead on whether Act 257 advances another purported purpose – namely, maintaining the existence of an independent body of gas station operators by preventing oil companies from raising rents to levels that would drive lessee-dealers out of business. The contention that Hawaii passed Act 257 to promote the viability of lessee-dealers for their own sake without regard to retail prices is inconsistent with the express views of the Hawaii Legislature in enacting Act 257. The Act's legislative findings and declarations state that:

> Because Hawaii is physically small and a geographically remote economy, certain of its markets tend to be concentrated. . . . In a highly competitive market, market prices tend to rise above competitive levels. *Market prices persistently above competitive levels are harmful to consumers and the public.*

(Emphasis added.) Act 257 failed to include a similar statement of legislative intent expressing a concern for lessee-dealers. Hawaii's current argument is also inconsistent with its position throughout this litigation and the testimony of its expert. The district court found that "while the legislature was mindful of the need to protect lessee dealers, this consideration was essentially a step toward the ultimate goal of reducing gasoline prices for

Hawaii consumers." *Chevron USA, Inc.*, 57 F. Supp. 2d at 1010. We accepted this characterization in *Chevron I* when we stated that "the district court found the purpose of Act 257 is to 'reduce gasoline prices for Hawaii's consumers'" and that "on appeal, the parties *do not contest this finding*." 224 F.3d at 1033 n.3 (emphasis added). Our prior opinion observes that whether Act 257 substantially advances its purpose "certainly depends on whether it will in fact lead to lower prices." *Id.* at 1041. Hawaii's expert, Dr. Keith Leffler, himself acknowledged the legislative connection between protecting lessee-dealers and the ultimate goal of lowering retail prices in his testimony before the district court: "The lease rent cap imposed by Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline markets in Hawaii by maintaining the viability of independent dealers and thereby benefit consumers by reducing gasoline prices below what they would be otherwise." The district court properly viewed Hawaii's concern over maintaining a network of independent lessee-dealers as a means to reducing retail gas prices, not an end in itself.

The district court analyzed the efficacy of maintaining independent lessee-dealers in the context of Hawaii's purpose for enacting the Act and found that Act 257 did not substantially advance Hawaii's interest in lower retail gas prices. Relying on the declaration and trial testimony of Dr. Leffler, the court found that Act 257 actually penalizes oil companies for maintaining lessee-dealer stations, stating that in the long term "there will ultimately be fewer lessee-dealer stations than there would be without Act 257" as oil companies decide where and what type of distribution avenues in which to invest. *Chevron USA, Inc.*, 198 F. Supp. 2d at 1191.

Although the court observed that Act 257 does "preclude[] oil companies from raising rents to levels designed to drive lessee-dealers out of business," *id.* at 1191, it found that "there is no evidence that, but for Act 257, Chevron or any other oil company would try to drive its lessee-dealers out of business in Hawaii by charging excessive rent." *Id.* (citing the trial testimony of Dr. Leffler that at the time Act 257 went into effect, Chevron charged relatively low rental prices). Hawaii maintains that this statement indicates that the district court improperly substituted its judgment for that of the legislature on the question whether the legislature's goal in enacting Act 257 was legitimate. Hawaii is correct that the "substantially advances" test reserves its heightened scrutiny for the state's purported means, not its goal. Clearly, the preservation of lessee-dealers was not the legislature's ultimate goal. The court's scrutiny was appropriate.

Based on the testimony of the parties' experts, the district court also made findings with respect to two factual questions we directed be resolved on remand – the effect of Act 257 on wholesale prices and the possibility that lessee-dealers will capture a premium. *Chevron I,* 224 F.3d at 1042. The district court found that the oil companies will offset the impact of Act 257 in part by increasing wholesale prices, which in turn will cause an increase in retail prices. *Chevron USA, Inc.,* 198 F. Supp. 2d at 1187-88. On this point, the court was persuaded by the testimony of Dr. Umbeck who testified that oil company pricing involves a search for the optimal balance between various revenue streams; a reduction in rental income, therefore, would necessarily effect how Chevron sets its wholesale prices. *Id.* The district court discounted the contrary opinion of Dr. Leffler that Act 257 would not

cause Chevron to increase wholesale prices because prices were already maximized. *Id.*

Regarding premiums, the court found that Chevron established by a preponderance of the evidence that the reduced rent mandated by the Act will not flow to consumers in the form of reduced retail prices but instead will allow lessee-dealers to capture a premium on their leaseholds. *Id.* at 1189-90. The parties stipulated that all other factors remaining constant, Act 257 would likely cause the market value of lessee-dealer leaseholds to increase. At trial, moreover, the parties' experts agreed that the lessee-dealers alone would realize any such increase; it would not be passed on to consumers in the form of lower retail prices. Because the court credited Dr. Umbeck's testimony that Chevron's increase in wholesale prices as a result of Act 257 would only partially offset the decrease in its rental income, the court concluded that the remaining amount will inure to lessee-dealers as a premium on the value of their leaseholds. *Id.* at 1189-90. In so finding, the court adopted Dr. Umbeck's view of the relevant economic market over the view of Dr. Leffler. *Id.*

Based on all the evidence adduced at trial, the district court concluded that Act 257 will not substantially advance a reduction in the retail price of gasoline. The court's factual findings and conclusions of law are consistent with the views of the parties' experts and are not clearly erroneous.

IV

It is argued that our application of the "substantially advances" test to the facts of this case improperly interprets the Supreme Court's decision in *Yee v. City of Escondido,*

503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). The argument maintains that even assuming *Yee* permits application of the substantially advances test to a rent control ordinance where there is only the possibility of a premium, as this court did in *Richardson* and *Chevron I*,[4] the test is inapplicable here where the testimony is that "in all likelihood," a premium will not exist.[5]

The argument relies on excerpts from the following colloquy between the court and Chevron's expert, Dr. Umbert, as support for the proposition that there is "probably no premium" created by Act 257:

> THE WITNESS: [Chevron] would try to raise the wholesale price to recoup as much of the lost rent as they could. . . . At the stations where they raise the price those stations will have a reduction in volume of gasoline they sell if the dealer raises his retail prices. . . .

[4] A concurrence in *Chevron I* argues that our holding that the substantially advances test applies when there exists only the possibility of a premium goes beyond our opinion in *Richardson*, which relies on *Yee*. *Compare* 224 F.3d 1030, 1035, *cert denied*, 532 U.S. 942, 149 L. Ed. 2d 346, 121 S. Ct. 1403 (2001), *with id.* at 1042 (W. Fletcher, J., concurring in the judgment).

[5] Implicit in this argument is the notion that the level of scrutiny we apply to rent control ordinances should be fluid throughout the course of the proceedings. That is, on a motion to dismiss or a motion for summary judgment where factual questions remain regarding the existence of a premium, we should apply the substantially advances test. But the standard we apply after experts have testified on the premium issue should depend upon the substance of that testimony – if there is the possibility of a premium, we should apply the substantially advances test; if not, we should apply the rational basis test. There is not precedent for such an approach.

> THE COURT: Then, if the offset is not total, mightn't consumers in deed [sic] benefit from Act 257 because, if the increase in the wholesale price is less than the decrease in rent, then the lessee dealer's overall cost would go down.
>
> THE WITNESS: No, no. The dealers overall revenues are going to fall because he's going to be selling gasoline. . . . Even if the oil company doesn't recover all of the rent reduction, that does not mean the dealer is going to benefit because the whole revenue stream is smaller. In fact, in all likelihood both the dealer would lose and the oil company would lose.
>
> . . .
>
> The reduction in rent by itself – let's suppose the oil companies do not raise their DTW for a second and they just lower rent to the dealer. There is no reason in our economic theory to believe that the retail prices would fall. That is, the dealer would just pocket the difference.
>
> THE COURT: Why is that?
>
> . . .
>
> THE WITNESS: It's actually an opinion shared by Dr. Leffler and myself and all economics text books. And that is that a fixed commitment to pay dollars each month in the form of rent does not affect the decision on how much gasoline to sell or what price to charge at the retail pump. But, when wholesale price goes up, then the incentive for the dealer to reduce his volume in order to save some of these variable costs will lead him to raise prices.

The opinion shared by the experts was not that lessee-dealers will fail to benefit as a result of Act 257; rather, Dr. Umbreck was explaining the widely-held belief that, all things remaining equal, any reduction in rental (fixed) costs realized by the dealers would not be passed on to consumers in the form of reduced retail prices. Hawaii's counsel made this clear during closing argument when he did not deny that lessee-dealers may capture a premium: "While it is true that incumbent dealers could try to charge a premium and a prospective purchaser could agree to pay that premium, . . . we do not believe that it will have any impact on the retail price of gasoline simply because the rent gap permits lessee-dealers to stay in business longer, increasing competition and lowering prices."

Furthermore, Dr. Umbreck's testimony that "in all likelihood" lessee-dealers will not benefit under Act 257 was based on an uncertain assumption about market behavior. Specifically, that Chevron's increase in wholesale prices and the resulting drop in sales would combine for a loss to lessee-dealers that is greater than the benefit realized by the reduced rent. Neither expert testified that this would necessarily occur. Indeed, in its opinion, the district court stated that "implicit in Prof. Umbreck's opinion [that Chevron would raise wholesale gasoline prices] is the assumption that Chevron will risk a drop in sales volume in the hope that it will be outweighed by the increase in wholesale price." *Chevron U.S.A. Inc.*, 198 F. Supp. 2d at 1189. That same uncertainty about market reaction accounts for the possibility that lessee-dealers will retain a *benefit* from the reduced rent, *i.e.*, a premium.

AFFIRMED

DISSENT BY: William A. Fletcher

DISSENT: W. FLETCHER, Circuit Judge, dissenting:

At issue in this case is the constitutionality of Hawai'i's Act 257, which controls the rent an oil company can charge its dealer/lessees. There are two different constitutional tests that could conceivably apply to Act 257. The first is the "reasonableness" test ordinarily applied to rent and price control statutes. *See, e.g., Pennell v. City of San Jose,* 485 U.S. 1, 11, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988) (upholding a rent control ordinance because it was not "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt") (quoting *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-70, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968)). The second is the "substantially advances a legitimate state interest" test ordinarily applied to zoning and other land use regulations. *See, e.g., Agins v. City of Tiburon,* 447 U.S. 255, 261, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980) (upholding a zoning ordinance because it "substantially advanced legitimate governmental goals"); *Dolan v. City of Tigard,* 512 U.S. 374, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994); *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987).

In *Richardson v. City and County of Honolulu,* 124 F.3d 1150 (9th Cir. 1997), we applied the "substantially advances" test to invalidate a rent control ordinance in which the tenant was able to capture a "premium" resulting from the ordinance. In an earlier appeal in this case, *Chevron USA, Inc. v. Cayetano* (*Chevron I*), 224 F.3d 1030, 1035 (9th Cir. 2000), this panel went beyond *Richardson,* holding that the "substantially advances" test must be applied to Act 257 because of the "stipulated

possibility that [a dealer/lessee] will be able to capture the value of the decreased rent in the form of a premium." That "possibility," in the view of the panel, "separated Act 257 from an ordinary rent control situation" in which the "reasonableness" test would be applied. *Id.* I disagreed with the majority's analysis in *Chevron I,* believing that the panel misunderstood Supreme Court case law applicable to rent control and therefore applied the wrong test. *Id.* at 1042 (W. Fletcher, J., concurring in the judgment).

In *Chevron I,* we remanded to the district court to apply the "substantially related" test to Act 257. After a hearing on remand, at which the only evidence presented was the opinion of one expert per side, the district court held that Act 257 did not satisfy the "substantially related" test. It concluded, "Act 257 effects an unconstitutional regulatory taking given its failure to substantially advance any legitimate state interest." *Chevron USA, Inc. v. Cayetano,* 198 F. Supp. 2d 1182, 1193 (D. Haw. 2002).

If "substantially advances a legitimate state interest" were the proper test to apply to Act 257, I would vote to affirm the district court. The evidence put on by the State's expert in support of Act 257 was sufficiently weak, and the countervailing evidence put on by Chevron's expert was sufficiently strong, that the district court did not err in concluding that this test was not satisfied. My problem is thus not with the manner in which the "substantially advances" test has been applied in this case. Rather, it is with the application of the test in the first place.

As I discussed in my concurrence in *Chevron I,* the only possible basis for the application of the "substantially

advances" test to a rent control statute is dictum in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992), in which the Supreme Court upheld a mobile home rent control ordinance against a physical takings challenge. The Court refused to consider whether the ordinance constituted a regulatory taking because that question had not been included in the grant of certiorari, but it briefly distinguished between physical and regulatory takings. It wrote:

> The effect of the rent control ordinance, coupled with the restrictions on the park owner's freedom to reject new tenants, is to increase significantly the value of the mobile home. This increased value normally benefits only the tenant in possession at the time the rent control is imposed. . . . Petitioners are correct in citing the existence of this premium as a difference between the alleged effect of the Escondido ordinance and that of an ordinary apartment rent control statute. . . . Petitioners contend that the Escondido ordinance transfers wealth only to the incumbent mobile home owner. This effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. *See Nollan v. California Coastal Comm'n*[, 483 U.S. 825, 834-35, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987)]. But it has nothing to do with whether the ordinance causes a *physical* taking.

Id. at 530.

It is undisputed that Chevron has the capacity to increase the wholesale price of gasoline to its dealer/

lessees who benefit from rent control under Act 257. Chevron's expert testified that "in all likelihood" the combined consequences of Act 257 would be an economic loss for the dealer/lessees and an increase in wholesale gasoline prices:

> Question [by the court]: Then why wouldn't Chevron raise the wholesale price for those stations to completely offset the rent reductions?
>
> Answer [by Dr. Umbeck]: Well, they would certainly try. . . . They would try to raise the wholesale price to recoup as much of the lost rent as they could, and the law of demand operating at each of those individual stations, however, is going to limit the total amount they're able to recoup. In other words, at the stations where they raise the price those stations will have a reduction in the volume of gasoline they sell if the dealer raises his retail prices, which logically he would. . . . At the individual stations that are affected there's going to be less revenue generated in total from gasoline sales because they're going to lose some customers. And so, even if the oil company doesn't recover all of the rent reduction, that does not mean the dealer is going to benefit because the whole revenue stream is smaller. *In fact, in all likelihood both the dealer would lose and the oil company would lose.*

(Emphasis added.)

As the challenger of Act 257, Chevron had an obvious interest in establishing that Act 257 would create a premium for its dealer/lessees since this would suggest that the statute is unconstitutional. Yet Chevron's own expert testified that "in all likelihood" a dealer would lose money. In other words, according to Chevron's own expert, there is

probably no premium created by Act 257. Far from gaining a premium, "in all likelihood" the dealer/lessees will lose money as a result of Act 257.

It is a long way from the quoted passage in *Yee* to the panel's holding in this case. The Court in *Yee* did not say, even in a case where there was an actual premium, that the *Nollan* "substantially advances" test would apply. Nor did the Court say that the "substantially advances" test would apply in a case where there was only the probability of a premium, instead of an actual premium. But even if the Court meant in *Yee* what it did not say, this case is a far cry from *Yee*. Here, the premium is not actual, nor even a mere probability. Rather, "in all likelihood," the premium does not exist.

We took a wrong turn in *Richardson*, we continued on the wrong path in *Chevron I*, and we are now in the wrong place. Under the panel's holding, "virtually all rent control laws in the Ninth Circuit are now subject to the 'substantially advances a legitimate state interest' test[,]" 224 F.3d at 1048 (W. Fletcher, J., concurring in the judgment), and many of those laws may well be held unconstitutional under that test. Rent control is often inefficient and sometimes unfair. *See id.* But we should not confuse inefficiency and unfairness with unconstitutionality.

I respectfully dissent.

CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI, Attorney General of the State of Hawaii, Defendants.

CIVIL NO. 97-00933 SOM

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII

198 F. Supp. 2d 1182; 2002 U.S. Dist. LEXIS 7086

April 1, 2002, Decided
April 1, 2002, Date Opinion Filed

COUNSEL: For Plaintiff: Robert A. Mittelstaedt, Pillsbury Winthrop LLP, San Francisco, CA.

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For Defendants: Charles A. Price, James Koshiba, Koshiba Agena & Kubota, Honolulu, HI.

JUDGES: SUSAN OKI MOLLWAY, UNITED STATES DISTRICT JUDGE.

OPINION BY: SUSAN OKI MOLLWAY

OPINION:

AMENDED FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER

1. INTRODUCTION.

This case is a challenge to a state law that caps the rent an oil company may charge someone who leases a service station owned by the oil company. Plaintiff Chevron U.S.A., Inc. ("Chevron"), argues that Act 257, passed by the Hawaii legislature in 1997, unconstitutionally

effects a regulatory taking because it fails to substantially further a legitimate state interest. The rent cap was instituted as part of the State of Hawaii's response to high gasoline prices. High prices caused the State of Hawaii to file a separate lawsuit, alleging that oil companies had conspired to keep the prices high. While the parties to the antitrust lawsuit reached a settlement, the present rent cap dispute went to trial. The court held a one-day bench trial on February 26, 2002, then ordered evidence reopened and received limited additional testimony on March 25, 2002. Having examined the evidence provided by economists, who were the only witnesses at trial, this court agrees with Chevron that the rent cap in Act 257 is unconstitutional.

This case has had a long history. Filed in 1997, this case was initially assigned to a different district judge, who granted summary judgment for Chevron on the grounds that Act 257 failed to substantially advance a legitimate state interest and therefore effected an unconstitutional taking. *See Chevron U.S.A., Inc. v. Cayetano,* 57 F. Supp. 2d 1003 (D. Haw. 1998). Defendants (collectively "the State") appealed that decision to the Ninth Circuit in *Chevron U.S.A., Inc. v. Cayetano,* 224 F.3d 1030 (9th Cir. 2000) ("Chevron Appeal"). The Ninth Circuit reversed, holding that there were genuine issues of material fact as to whether Act 257 effected an unconstitutional taking by failing to substantially advance its purpose of lowering gasoline prices for consumers. *See id.* at 1038-1041. The Ninth Circuit remanded the case for resolution of questions of fact, including: (1) whether oil companies would offset the benefits of Act 257 by raising the wholesale price of gasoline, and (2) whether incumbent lessee-dealers would sell their leaseholds at a premium representing the

increased value resulting from the rent cap, so that new dealers who had to pay that premium would receive no net benefit from the rent cap to pass on to consumers. *Id.* at 1042.

Based on the evidence presented at the trial held on February 26, 2002, this court[1] finds that Act 257 will not decrease retail gasoline prices. In fact, it will cause retail gasoline prices to increase. Act 257 will also discourage oil companies from investing in lessee-dealer stations. It will create no incentive for lessee-dealers to continue operating their stations through lower operating costs. Instead, Act 257 will create a premium that lessee-dealers can recognize upon selling their leases. Act 257 will not advance the goal of lowering gasoline prices.

II. FINDINGS OF FACT.

Whenever, in the following discussion, this court has mistakenly designated as conclusions of law what are really findings of fact, and vice versa, the court's statements shall have the effect they would have had if properly designated.

This bench trial was conducted in accordance with this court's trial procedures for civil nonjury trials, which are reproduced, in substantially the same form followed here, in Appendix A to this court's decision in *Kuntz v. Sea Eagle Diving Adventures Corp.*, 199 F.R.D. 665 (D. Haw. 2001). The court heard testimony from two expert

[1] Following remand, a new circumstance arose that required the original district judge to recuse himself. The case was reassigned to the present district judge.

witnesses: John Umbeck, Ph.D. ("Prof. Umbeck"), who testified on behalf of Chevron, and Keith Leffler, Ph.D. ("Prof. Leffler"), who testified on behalf of the State. Direct examinations of both witnesses were submitted to this court in the form of written declarations. Both witnesses appeared live for cross-examination and redirect examination. The court admitted into evidence three exhibits: Defendant's Ex. 1 (Prof. Leffler's direct testimony by declaration), Plaintiff's Ex. 14 (Prof. Umbeck's direct testimony by declaration), and Plaintiff's Ex. 15 (pages A2-A5 of Exhibit A attached to the Stipulation Re: Adoption of Stipulation of Facts for Trial, filed Feb. 22, 2002).

For ease of reference by the parties and the court, the following findings are presented in numbered paragraphs.

Background.

1. On June 21, 1997, the State of Hawaii enacted Act 257. Stip. of Facts ¶ 1. Act 257 regulates the maximum rent an oil company may charge a dealer that leases a service station from the oil company. The rent is capped at 15 percent of the dealer's gross margin on actual gasoline sales. Haw. Rev. Stat. § 486H-10.4(c)(2) (1998). Act 257 does not apply to any dealer lease in effect on August 1, 1997. Stip. of Facts ¶ 40.

2. In passing Act 257, the legislature was concerned about the level of concentration at the wholesale level in the gasoline industry. Trial Testimony by Keith Leffler, Tr. at 89:7-14, 96:18-24. The legislature passed Act 257 to reduce gasoline prices for Hawaii's consumers. *See Chevron Appeal*, 224 F.3d at 1033 n.3.

3. Hawaii's gasoline market is an oligopoly at the wholesale level but very competitive at the retail level. An oligopoly is a market with few sellers. Decl. of Keith Leffler (Ex. 1) ¶ 9. A competitive market, by contrast, is one with many sellers. Decl. of Keith Leffler (Ex. 1) ¶ 9.

4. In a competitive market, no one seller is individually significant enough to have a measurable impact on the industry supply. Sellers therefore act independently of each other. A market with only a few sellers is a "highly concentrated" market. In such a market, each seller recognizes that its decisions will significantly affect the market and its competitors. Each seller therefore takes into account how its competitors will react to its decisions about marketing, supply, and price. The sellers are interdependent, rather than independent, competitors. Reduced competition is likely when the market is highly concentrated. In an oligopoly, an individual firm pursuing its own individual interests will not "rock the boat" and will try to avoid price wars and battles for market share. High concentration may have the anticompetitive effect of causing what few firms there are to cooperate tacitly, resulting in high prices to consumers. Decl. of Keith Leffler (Ex. 1) ¶ 10.

5. The level of concentration in an industry may be measured by the Herfindahl Hirschman Index, or HHI. The HHI is calculated by adding the squared values of the market shares of each company in the industry. Trial Testimony by Keith Leffler, Tr. at 90:22-91:1. If the HHI in a market exceeds 1,800, that market is considered highly concentrated. Trial Testimony by Keith Leffler, Tr. at 91:6-9. The HHI is used by the Department of Justice and the Federal Trade Commission, among others, to measure

concentration levels. Trial Testimony by Keith Leffler, Tr. at 89:18-21.

6. In 1997, Hawaii had two refineries that supplied gasoline to essentially six wholesalers. Decl. of Keith Leffler (Ex. 1) ¶ 9. With an HHI greater than 1,800, the wholesale gasoline market in Hawaii is highly concentrated. Trial Testimony by Keith Leffler, Tr. at 91:10-12.

7. Hawaii's retail gasoline stations come in three types: company-operated stations, which are owned and operated by oil companies marketing their own products; lessee-dealer stations, which are leased by retail dealers from oil companies; and independent stations, sometimes called "two-party dealers" or "open dealers," which are stations that are neither owned by nor leased from oil companies and that make their own decisions about whose gasoline they will buy. Decl. of John Umbeck (Ex. 14) ¶ 6. Company-operated stations tend to enjoy more efficiencies than lessee-dealer stations. On average, when the gasoline price charged to the dealers (the "Dealer Tank Wagon price" or "DTW") is held constant, company-operated stations charge less for gasoline than other stations. Trial Testimony by Keith Leffler, Tr. at 111:5-16.

8. With an HHI of around 150, the retail gasoline market in Hawaii is very unconcentrated, or highly competitive. Trial Testimony by Keith Leffler, Tr. at 96:7-17. To calculate the HHI at the retail level, Prof. Leffler, testifying for the State, grouped together all stations operated by a single oil company, counting them as a single entity deciding on retail prices as a unit. Stations operated by lessee-dealers and open dealers were counted individually, on the theory that such stations decided on

retail prices independently. Trial Testimony by Keith Leffler, Tr. at 95:6-9.

9. Under Chevron's lessee-dealer arrangement, Chevron purchases land or leases it from a third party, makes the entire investment to build the service station and to build the related facilities on each location, and leases the land and facilities to the dealer on a turn-key basis. Stip. of Facts ¶ 7. Chevron incurs ongoing expenses attributable to the lessee-dealer rental property, such as ground lease rents, real property taxes, ordinary maintenance (subject to the terms and conditions of the dealer lease), and the accounting expense entry of "depreciation." Stip. of Facts ¶ 8.

10. Chevron's lessee-dealer arrangements have two parts. There is a lease under which Chevron charges the lessee-dealer a monthly lease rent. There is a separate supply contract under which Chevron sells motor fuels to the lessee-dealer at a price unilaterally determined by Chevron. Chevron does not enter into a dealer lease unless the dealer simultaneously executes a supply contract with Chevron. Stip. of Facts ¶ 9. In other words, Chevron requires each lessee-dealer to market Chevron-branded gasoline purchased directly from Chevron as a condition of Chevron's entering into a lease with the dealer. Stip. of Facts ¶ 15. Although any dealer that installs its own pumps and tanks is legally free to purchase non-Chevron gasoline, each Chevron lessee-dealer in Hawaii currently obtains (and has obtained for at least the last 10 years) its supply of gasoline exclusively from Chevron. Stip. of Facts ¶ 16.

11. Effective January 1, 1997, Chevron implemented a new nationwide dealer rental program that restructured

the manner in which Chevron calculated rents paid under service station leases. Stip. of Facts ¶ 2. Chevron's dealer leases run for three-year terms. The exception is that, if Chevron is leasing land for a particular service station from another party under a ground lease that expires in less than three years, the dealer lease expires when the ground lease expires. Stip. of Facts ¶ 24.

12. The lease rent cap provisions contained in Act 257 prohibit complete implementation in Hawaii of the rent rates specified in Chevron's new dealer rental program. Stip. of Facts ¶ 3. Absent Act 257, Chevron would have charged "motor fuel facilities rent" that would have been a percentage of the dealer's gross margin on motor fuel sales (total motor fuel sales volume multiplied by weighted average per gallon margin). Chevron's new rental program had three different percentage brackets applied on an incremental basis to the monthly gross margin on fuel. The rent would have been 18 percent on the portion up to $18,000; 32 percent on the portion between $18,000 and $28,000; and 38 percent on the portion over $28,000. However, Act 257 does not allow Chevron to charge the "motor fuel facilities" rent that it otherwise would have charged. Stip. of Facts ¶ 4. The rental provisions of Act 257 also cause Chevron to require that dealers account for automotive service bay sales, which it otherwise would not do. Stip. of Facts ¶ 6. Act 257 has no direct impact on non-motor fuel facilities rent under Chevron's rental program because the 15 percent cap is greater than what Chevron would have otherwise charged as non-motor fuel facilities rent without Act 257. Stip. of Facts ¶ 4.

13. Chevron estimates that, after all lessee-dealer agreements in Hawaii are renewed under Act 257, the Act

will preclude Chevron from charging the rent it otherwise would have charged for 11 of Chevron's 64 lessee-dealer stations in Hawaii. Stip. of Facts ¶ 5; *see also* Table 1, attached to Stip. of Facts.[2]

14. Chevron has invested more than $58,000,000 in its current lessee-dealer service stations and related facilities in Hawaii. The present book value of those same service stations and related facilities is more than $37,000,000. Stip. of Facts ¶ 10. The maximum amount of rent Chevron projects it could receive under the statutory scheme imposed by Act 257, when applied to all Chevron dealer leases in Hawaii, is $6,126,646 for the 12-month period from January 1, 1998, through December 31, 1998. Stip. of Facts ¶ 12. Chevron's projected expenses during the 12-month period from January 1, 1998, to December 31, 1998, for its lessee-dealer stations in Hawaii, i.e., ground lease rents, real property taxes, ordinary maintenance, depreciation, and other direct station expenses, total $6,292,855, exceeding Chevron's projected rental income by $166,209. Stip. of Facts ¶ 13.

15. Chevron would not invest in lessee-dealer stations except for its expectation that Chevron gasoline will be sold at such stations. Stip. of Facts ¶ 14. Chevron recovers its expenses and investment costs relating to

[2] Table 1 is an accurate summary of the projected rents for each Chevron lessee-dealer station in Hawaii for the first year of Act 257. Table 1 also reflects the agreement Chevron has with its lessee-dealers pending final disposition of this lawsuit. That agreement limits the rent Chevron charges during the pendency of this lawsuit but provides for dealers who benefit from that limit to make additional payments to Chevron in the event Chevron prevails in this lawsuit. Stip. of Facts ¶¶ 5, 11. The court has no empirical data on the full impact of Act 257.

lessee-dealer stations (ground-lease rents, real property taxes, ordinary maintenance, and depreciation) in Hawaii and throughout the United States through the combination of rental revenue and earnings on Chevron gasoline sold through the stations. Stip. of Facts ¶ 17.

16. Chevron's evaluation of the return on investment from the development of new lessee-dealer stations in Hawaii and throughout the United States includes in the return a measure of the expected earnings from the sale of Chevron-branded gasoline at the station. Stip. of Facts ¶ 18.

17. In the aggregate, Chevron has not within the last 20 years recovered its expenses relating to dealer stations (ground lease rents, real property taxes, ordinary maintenance, and depreciation) in Hawaii or elsewhere in the United States from dealer station rents. Stip. of Facts ¶ 23.

18. However, when all sources of revenue are considered, Chevron has positive net earnings from selling gasoline to Hawaii resellers. Stip. of Facts ¶ 22.

Oil companies will raise wholesale gasoline prices to offset any decrease in rent imposed by Act 257, and this increase in wholesale prices will cause retail prices to increase.

19. It makes no sense to consider revenues from rent separately from revenues from gasoline sales for purposes of an economic analysis. Oil companies consider both sources of revenues in setting their rents and gasoline prices and in making investment decisions. Trial Testimony by John Umbeck, Tr. 61:9-62:9, 104:21-105:13. Chevron determines the optimal mix between rent and

gasoline charges based on the total package cost that dealers or the market will permit. Different oil companies have different views on the optimal mix. Trial Testimony by Keith Leffler, Tr. at 97:14-20, 145-6:146-21.

20. A fixed cost, or sunk cost, is one that occurs "independently of how much the firm produces, or whether it produces at all." Decl. of Keith Leffler (Ex. 1) ¶ 22 (quoting G. Silberberg, Principles of Microeconomics 261 (Prentice Hall 1995)). Rent is a fixed cost. Trial Testimony by John Umbeck, Supp. Tr. at 10:8-13.

21. Both sides agreed that, because rent is a fixed cost, lessee-dealers will not pass the savings from a decrease in rent onto consumers in the form of lower retail prices. Instead, dealers will pocket the savings. Therefore, a decrease in rent will not, by itself, lower the retail price. Trial Testimony by John Umbeck, Supp. Tr. at 9:15-10:13, 11:17-12:8.

22. To the extent observations on the subject are available, demand for gasoline is inelastic in Hawaii. Elasticity is determined by comparing the percentage change in the quantity of gasoline sold to the percentage change in the price of gasoline. Trial Testimony by John Umbeck, Tr. at 34:9-14. Thus, to say the demand appears inelastic is to say that, to the extent observations have been made on the subject, changes in the retail price of gasoline have caused the volume of gasoline purchased to change by proportionally less than the change in price.

23. Chevron will increase its wholesale gasoline price to offset the reduction in rental revenue it receives as a result of Act 257. Decl. of John Umbeck (Ex. 14) ¶ 20. Dealers will respond to the increase in the wholesale price by raising retail prices. Trial Testimony by Keith Leffler,

Tr. at 100:4-9, 142:3-8, 142:21-23; Trial Testimony by John Umbeck, Supp. Tr. at 6:3-5, 10:13-16, 12:9-10. This will cause the volume of gasoline sold by Chevron to decrease because the customers at Chevron stations that increase retail prices will respond to the higher retail prices by purchasing less gasoline and by defecting to stations that have not raised retail prices. Trial Testimony by John Umbeck, Supp. Tr. at 6:5-8.

24. This decrease in volume will prevent Chevron from raising the wholesale price enough to offset completely lost rental revenues. Chevron will be able to offset those lost revenues only partially. Trial Testimony by John Umbeck, Supp. Tr. at 5:15-6:10.

25. Chevron may accomplish this partial offset by raising wholesale prices only for the lessee-dealer stations affected by Act 257's rent cap. Setting wholesale prices for specific stations would be a change in Chevron's pricing practice in Hawaii. In Hawaii, Chevron's current policy is to treat each island as a separate wholesale price zone. Presumably, this policy is optimal for maximizing profits. In some markets, such as Los Angeles and San Francisco, where administrative costs are not prohibitive, Chevron has multiple price zones within a city. To do the same in Hawaii would not cause administrative costs to increase very much. Trial Testimony by John Umbeck, Supp. Tr. at 6:19-8:12.

26. Testifying for the State, Prof. Leffler opined that Chevron will not raise the wholesale price in response to the rent cap. The court is not persuaded by Prof. Leffler. Prof. Leffler opined that Chevron would not raise the wholesale gasoline price because that would cause retailers to buy less gasoline from Chevron. Decl. of Keith

Leffler (Ex. 1) ¶ 16. Prof. Leffler explained that, as any rational oil company would maximize its profit, the wholesale price charged even without the effect of Act 257 must already be the highest price the oil company could charge to maximize its profits. He concluded that Act 257 would therefore not cause an increase in the wholesale price because this would not maximize profits. Decl. of Keith Leffler (Ex. 1) ¶ 17; Trial Testimony by Keith Leffler, Tr. at 185:22-186:14, Supp. Tr. at 13:22-14:5. According to Prof. Leffler, the wholesale price turns on demand, supply, and the relationships among the few suppliers, not on rent. Decl. of Keith Leffler (Ex. 1) ¶ 17.

27. Prof. Leffler ignores the relationship of rent to the wholesale price. As noted above, oil companies look at their total return and find the optimal mix among sources of revenue. The wholesale price is always set in light of the rent being charged. Trial Testimony by John Umbeck, Supp. Tr. at 15:5-23. Typically, dealer rents are below market, so the idea of "profit maximizing" does not appear to apply to individual components of the total return. Trial Testimony by John Umbeck, Tr. at 68:14-69:11.

28. Testifying for Chevron, Prof. Umbeck opined that Chevron would raise the wholesale gasoline price despite the possibility that sales would decrease if retail prices increased as a result. Prof. Umbeck noted that, even with a loss in sales volume, an increase in its wholesale price would allow Chevron to recoup part of the rent reduction, while holding wholesale prices steady would force Chevron to bear the full impact of the rent reduction. Decl. of John Umbeck (Ex. 14) ¶ 22.

29. Implicit in Prof. Umbeck's opinion is the assumption that Chevron will risk a drop in sales volume in the

hope that it will be outweighed by the increase in the wholesale price, such that wholesale gasoline revenues increase. If Chevron holds wholesale prices steady, then Chevron is guaranteed to lose the full difference between the rent it would have charged and the maximum rent allowed by Act 257. Under these circumstances, there is no evidence that Chevron would choose the guaranteed drop in revenue that would result from the rent cap if wholesale prices were not changed, rather than at least some possible recoupment of the reduced rent revenue through increased wholesale prices.

30. Prof. Umbeck's testimony is more persuasive than Prof. Leffler's on this point. At trial, the court had the opportunity to observe the demeanor of both witnesses during their cross-examinations and redirect examinations. Both were qualified as experts by the court, without objection by any party, and were permitted to present opinions in this case under Fed. R. Evid. 702. Both were clearly experienced economists well-versed in the circumstances of this case. Neither witness gave the court any reason to think the witness was insincere, although both were cautious and guarded in their responses. On occasion, both appeared reluctant to answer particular questions directly, attempting instead to impose boundaries to the questions, sometimes more than appeared warranted. Prof. Umbeck engaged in this practice more than Prof. Leffler did. Nevertheless, on the issue of whether wholesale prices would increase, the court was ultimately persuaded by Prof. Umbeck that they would increase. The court looked for but cannot point to demeanor evidence supporting this finding. The court instead relies on the logic and consistency of Prof. Umbeck's testimony on this point, as noted in the preceding paragraphs.

31. Act 257 will not advance its stated interest of lowering consumer gasoline prices. As noted above, lessee-dealers will not pass on any savings in rent to consumers in the form of lower retail prices. Instead, dealers will pocket the savings for themselves. The direct effect of Act 257 will actually be to cause retail gasoline prices to increase in response to higher wholesale gasoline prices, as noted above.

Act 257 will enable lessee-dealers to sell their leaseholds at a premium.

32. Chevron's leases and supply contracts with lessee-dealers permit the lessees to assign their occupancy rights, subject to obtaining Chevron's written consent and paying a transfer fee set by Chevron before the assignment of any lease or any interest in a lease. Stip. of Facts ¶ 26.

33. Neither Chevron's dealer lease nor Chevron's dealer supply contract limits the price at which a lessee-dealer may sell, convey, or otherwise transfer its occupancy rights. Stip. of Facts ¶ 27. Nor does Act 257 prohibit the sale, conveyance, or other transfer of leases by service station dealers, or limit in any way the price at which a lessee dealer may sell, convey, or otherwise transfer its interest in a service station lease. Stip. of Facts ¶¶ 28, 29.

34. From 1992 to 1998, 14 Chevron lessee-dealers sold their interests in their gasoline stations to other entities. Stip. of Facts ¶ 32. Chevron expects that further assignments of leases and supply contracts will occur in the future. Stip. of Facts ¶ 33.

35. In Hawaii, a Chevron lessee-dealer's earnings from gasoline sales depend on factors that include the

dealer's expertise and business acumen, the location of the station, the features of the station, the location of competitors' stations, the pricing at competitors' stations, the lessee-dealer's rent, other station costs, and the price paid by the dealer to Chevron for gasoline. Stip. of Facts ¶ 26.

36. Assuming everything else remains equal, the market value of a lessee-dealer's leasehold could reasonably be expected to increase as the amount of the rent payable decreases. Stip. of Facts ¶ 35.

37. Having accepted Chevron's argument that wholesale prices will increase in response to the rent cap, the court finds that "everything else," referred to in the preceding paragraph, will not remain equal. Nevertheless, a preponderance of the evidence establishes that Act 257 will enable lessee-dealers to sell their leaseholds at a premium.

38. Act 257's rent cap will generate a premium that reflects the difference between the incumbent dealer's expected market rent and the lower rent resulting from Act 257, discounted by the appropriate interest rate for the expected life of the station. Decl. of John Umbeck (Ex. 14) ¶ 23. As noted above, the increase in wholesale gasoline prices will not completely offset the decrease in rent. The resulting benefit to the lessee-dealer shows up in the premium.

39. Prof. Leffler disagreed that Act 257 would create a premium. He pointed to the many unknown variables that would affect the creation of a premium, such as future rent, future gasoline margins, and stations' sales of products other than gasoline. Decl. of Keith Leffler (Ex. 1) ¶ 24. The court disagrees. Economic theory takes these unknown variables into account by predicting expected

values that will be capitalized in the form of a premium. Decl. of John Umbeck (Ex. 14) ¶ 29. Even though some purchasers may overestimate or underestimate the value of the premium, on average, the value of each premium paid will equal the actual present value of the rent reduction. Decl. of John Umbeck (Ex. 14) ¶ 30.

40. Prof. Leffler opined that a second reason lessee-dealers would not fully capture a premium from rent reductions is that the market for the sale of lessee-dealer rights in Hawaii is not perfectly competitive. Decl. of Keith Leffler (Ex. 1) ¶ 24. Again, the court disagrees. Prof. Leffler admitted on cross-examination that he did not know whether the market is perfectly competitive or not. Testimony by Keith Leffler, Tr. at 98:13-24. Moreover, the evidence Prof. Leffler relied on did not actually prove his point. Prof. Leffler relied on the low number of sales of dealer rights per year. Decl. of Keith Leffler (Ex. 1) ¶ 24. However, the number of sales of dealer rights per year says nothing about the competitive nature of the market. For example, perfect competition may take the form of an auction with many potential buyers who bid against each other. Even though only one sale is actually made, the market is still perfectly competitive. Because a lessee-dealer will not sell his lease unless he receives an offer price with a present value equal to the present value of his expected income stream, the sale price will fully capture the original dealer's expected future value in the form of a premium. Decl. of John Umbeck (Ex. 14) ¶ 31.

41. At trial, the court expressed concern that the State had not cross-examined Prof. Umbeck at all on the issue of the asserted premium. The court had envisioned that, in the wake of the Ninth Circuit's decision in this case, both parties would conduct vigorous cross-examination on

all issues. That did not occur. The State's counsel explained that the State had made a "strategic decision" not to touch the premium issue. Tr. at 200:13-203:11. The court would have been greatly aided by crossexamination on this subject. The Ninth Circuit clearly contemplated that such cross-examination would illuminate the factfinding process. Without the anticipated cross-examination, the court examines whether Chevron's argument as to the existence of a premium is supported by a preponderance of the evidence. It is.

Instead of decreasing retail gasoline prices by maintaining the presence of lessee-dealers in the market, Act 257 will increase retail gasoline prices by reducing the number of lessee-dealers.

42. Prof. Leffler testified that gasoline prices in Hawaii are relatively high at the wholesale and retail levels because of (a) high taxes; (b) high concentration at the wholesale level; and (c) high barriers to entry that dissuade new companies from entering the market. These barriers include substantial fixed costs, regulatory impediments to building new terminals, an oversupply of gasoline stations in the market, and an adverse political climate, including rent controls, government proposals to take over petroleum terminals, and restrictions on the location and types of stations that may be built. Trial Testimony by Keith Leffler, Tr. at 114:13-117:14, 118:17-120:8.

43. The State contends that Act 257 will prevent oil companies from raising lessee-dealers' rents to unprofitable levels and thereby driving them out of business. *See* Defs.' Final Written Argument at 1-2. The State argues that, by maintaining the presence of lessee-dealers, Act

257 will lessen the anti-competitive impact of the highly concentrated wholesale gasoline market. Act 257 will do this, according to the State, by (a) preventing increased concentration at the retail level and (b) deterring cooperative pricing among the relatively few suppliers of gasoline at the wholesale level. Decl. of Keith Leffler (Ex. 1) ¶¶ 13, 14. The court is unpersuaded.

44. Prof. Leffler admitted that the rents that Chevron and other oil companies charge their lessee-dealers do not cause wholesale and retail gasoline prices in Hawaii to be high. Trial Testimony by Keith Leffler, Tr. at 120:11-16, 121:17-24.

45. Admittedly, the rent cap of Act 257 precludes oil companies from raising rents to levels designed to drive lessee-dealers out of business. Decl. of Keith Leffler (Ex. 1) ¶¶ 19. However, there is no evidence that, but for Act 257, Chevron or any other oil company would try to drive its lessee-dealers out of business in Hawaii by charging excessive rent. In fact, at the time Act 257 went into effect in 1997, Chevron charged rents that were relatively low. Trial Testimony by Keith Leffler, Tr. at 105:19-25, 162:11-163-5.

46. Prof. Leffler admitted that the percentage of lessee-dealers does not affect the wholesale concentration level or any of the other causes of high wholesale and retail gasoline prices in Hawaii. Trial Testimony by Keith Leffler, Tr. at 120:23-121:7, 121:12-16.

47. Act 257 will not alter the concentration level in the wholesale gasoline market. If Act 257 were to have any impact, it would be at the retail level, i.e., on the number of retail gasoline stations and lessee-dealers. Trial Testimony by John Umbeck, Tr. at 66:9-17.

48. Oil companies, not lessee-dealers, decide whether to build new lessee-dealer stations. Trial Testimony by Keith Leffler, Tr. at 123:1-9. Therefore, to determine how Act 257 affects decisions to build new lessee-dealer stations, the court focuses on the oil company's economics. Those economics will cause the number of lessee-dealer stations to decrease.

49. By reducing rental revenues, Act 257 discourages oil companies from investing in lessee-dealer stations rather than other types of gas stations. As noted above, the decrease in rental revenue will not be completely offset by an increase in the wholesale gasoline price. Therefore, oil companies will receive less total revenue from lessee-dealer stations than before, leading oil companies to avoid investing in new and existing lessee-dealer stations. This means that there will ultimately be fewer lessee-dealer stations than there would be without Act 257. Decl. of John Umbeck ¶¶ 15-17; Trail Testimony by Keith Leffler, Tr. at 182:12-19.

50. Act 257's rent cap will not cause lessee-dealers to remain in the market longer by lowering their operating costs. Although lessee-dealers will not have to pay as much rent, they will have the opportunity to capture the value of the rent reduction upon sale in the form of a premium, which they can then invest and earn a return on. Lessee-dealers will incorporate the cost of this opportunity into their operating costs. This opportunity cost will be exactly equal to the reduction in the monthly rent. Therefore, lessee-dealers' total operating costs will not decrease, and they will have no incentive to remain in the market longer than they otherwise would have. Decl. of John Umbeck ¶ 25.

51. Fewer lessee-dealer stations in the market means that retail prices will increase. In the first place, fewer lessee-dealers means greater concentration at the retail level, which means less intrabrand and interbrand competition. In the second place, the fewer lessee-dealers there are, the easier it is for wholesale gasoline suppliers to engage in cooperative pricing, leading ultimately to higher wholesale and retail prices. Decl. of Keith Leffler ¶¶ 13-15.

III. CONCLUSIONS OF LAW.

1. The Takings Clause of the Fifth Amendment of the United States Constitution states, in relevant part, "Nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V. The Takings Clause applies to the states through the Fourteenth Amendment. *See, e.g., Dolan v. City of Tigard,* 512 U.S. 374, 383-84, 129 L. Ed. 2d 304, 114 S.Ct. 2309 (1984).

2. "[W]hile property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Chevron Appeal,* 224 F.3d at 1033 (quoting *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922)).

3. Act 257 effects a regulatory taking if it does not "substantially advance a legitimate state interest." *See Chevron Appeal,* 224 F.3d at 1037; *see generally Agins v. City of Tiburon,* 447 U.S. 255, 260, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980). Chevron has the burden of proving by a preponderance of the evidence that Act 257 does not substantially advance a legitimate state interest. *Chevron Appeal,* 224 F.3d at 1037.

4. The State has a legitimate state interest in lowering consumer gasoline prices. *See Chevron Appeal,* 224 F.3d at 1033 n. 3; *see also Nollan v. California Coastal Com'n,* 483 U.S. 825, 834-35, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987) (a broad range of governmental purposes satisfies the requirement of a legitimate state interest).

5. Act 257 does not substantially advance this legitimate state interest. To the contrary, as noted above, Act 257 will cause consumer gasoline prices to increase. Gasoline suppliers will raise wholesale gasoline prices to offset the reduction in rental income, causing dealers to raise retail gasoline prices in response. Act 257 will also cause retail prices to increase by reducing the presence of lessee-dealers in the market. Act 257's rent cap discourages oil companies from investing in lessee-dealer stations. Under the Petroleum Marketing Practices Act (the "PMPA"), 15 U.S.C. §§ 2801-2806 (1998), an oil company may decline to renew a franchise relationship if renewal is "likely to be uneconomical to the franchisor," 15 U.S.C. § 2802(b)(3)(D)(i)(IV) (1998), subject to certain conditions, *see* 15 U.S.C. § 2802(b)(3)(D)(ii)-(iii) (1998).

6. Under Act 257, a lessee-dealer realizes a premium if it sells its leasehold. While premiums are not all unconstitutional *per se,* Act 257's premium undermines the legitimate state interest in lowering consumer gasoline prices. In *Richardson v. City and County of Honolulu,* 124 F.3d 1150, 1165-66 (9th Cir. 1997), the Ninth Circuit held a rent cap unconstitutional because the rent cap did not substantially further a legitimate state interest. *Richardson* concerned the constitutionality of the City and County of Honolulu's Ordinance 91-96. Ordinance 91-96 capped renegotiated rents on the land underlying owner-occupied

condominiums and provided that, if a lease was transferred to another owner-occupant, the transferee would enjoy the benefit of the capped rent. *See id.* at 1163-64. Ordinance 91-96 therefore was intended to create affordable owner-occupied housing directly by decreasing the land rents that condominium owner-occupants had to pay. *See id.* at 1165. However, the Ninth Circuit found that the price of housing would not ultimately change because an owner-occupant who sold his condominium would charge the buyer a premium reflecting the value of the decreased land rent. The lack of a mechanism to preclude lessees from capturing this premium prevented Ordinance 91-96 from substantially furthering a legitimate state interest, thereby rendering it unconstitutional. *See id.* at 1166.

7. Unlike Ordinance 91-96, Act 257 was not designed to lower retail gasoline prices directly through reduced rents. The parties agree that any rent savings will be pocketed by lessee-dealers. Instead, the State says, Act 257 will lower retail gasoline prices indirectly, by maintaining the presence of lessee-dealers in the market through reduced operating costs. Act 257 fails to accomplish this goal because lessee-dealers who benefit from Act 257's rent cap will be able to sell their leaseholds at a premium. The opportunity to capture this premium will be reflected as an operating cost, which will be equal in magnitude to the reduction in rent the lessee-dealers enjoy. Therefore, lessee-dealers' total operating costs will not change, giving lessee-dealers no added incentive to remain in the market.

8. There is no evidence that Act 257 will protect any lessee-dealer from being driven out of the market. There is no evidence that, but for Act 257, oil companies would try to drive lessee-dealers out of business by raising rents.

Moreover, the PMPA already prevents an oil company from raising rents for the purpose of driving dealers out of business and converting the premises to company-operated stations. 15 U.S.C. § 2802(b)(3)(A)(ii) (1998).

9. Act 257 effects an unconstitutional regulatory taking given its failure to substantially advance any legitimate state interest.

IV. ORDER.

Based on the above findings of fact and conclusions of law, the court declares the rent cap in Act 257 unconstitutional. Act 257's imposition of a cap on the rent that an oil company may charge a lessee-dealer does not substantially advance the State's legitimate interest in lowering gasoline prices. The previously entered judgment in favor of Chevron stands.

IT IS SO ORDERED.

DATED: Honolulu, Hawaii, April 1, 2002.

SUSAN OKI MOLLWAY
UNITED STATES DISTRICT JUDGE

CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff-Appellee, v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I ANZAI,* Attorney General of the State of Hawaii, Defendants-Appellants.

***Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).**

No. 99-15108

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

224 F.3d 1030; 2000 U.S. App. LEXIS 22938; 2000 Cal. Daily Op. Service 7631; 2000 Daily Journal DAR 10129; 31 ELR 20091

November 4, 1999, Argued and Submitted, Honolulu, Hawaii
September 13, 2000, Filed

COUNSEL: Jack A. Rosenzweig and Ted Gamble Clause, Deputy Attorneys General, Honolulu, Hawaii, for the defendants-appellants.

Robert C. Phelps and Craig E. Stewart, Pillsbury, Madison & Sutro, San Francisco, California, for the plaintiff-appellee.

JUDGES: Before: Dorothy W. Nelson, Robert R. Beezer, and William A. Fletcher, Circuit Judges. Opinion by Judge Beezer; Concurrence by Judge W. Fletcher.

OPINION BY: Robert R. Beezer

OPINION:

BEEZER, Circuit Judge:

Hawaii Governor Benjamin J. Cayetano and Attorney General Earl I. Anzai (collectively "the State") appeal the district court's judgment in favor of Chevron U.S.A., Inc. Chevron filed suit for declaratory and injunctive relief against enforcement of Section 3(c) of Act 257 of the 1997 Hawaii State Legislature ("Act 257"). Act 257, inter alia, proscribes the maximum rent that oil companies can collect from dealers who lease company-owned service stations. Both parties moved for summary judgment on whether the maximum permissible regulated rent effects an unconstitutional regulatory taking. After concluding that it does, the district court granted Chevron's motion and denied the State's motion. The State appeals only the grant of summary judgment to Chevron; it does not appeal the denial of its own motion. We have jurisdiction under 28 U.S.C. § 1291. Because genuine issues of material fact exist, we vacate the judgment and remand for further proceedings.

I

In response to concerns about the highly concentrated gasoline market in Hawaii and the resulting high cost of gasoline to consumers, the Hawaii Legislature enacted Act 257 on June 21, 1997.[1] Act 257, inter alia, regulates the maximum rent an oil company can charge dealers who lease its service stations.

Chevron is one of two gasoline refiners and one of six wholesalers in Hawaii. At the retail level, Chevron sells

[1] The relevant portions of Act 257 were later codified as Hawaii Revised Statute § 486H-10.4.

most of its gasoline through company-owned stations, which are leased to independent dealers. Chevron leases 64 service stations to dealers in Hawaii. From 1984 through the end of 1996, Chevron relied on *estimated* gasoline sales to calculate the rent owed by the lessee dealers. After determining that the amount of gross rent receipts was not satisfactory, Chevron initiated a new nationwide dealer rental program in January 1997. Chevron restructured the manner in which it calculated lease rates. This program, which the parties agree would be in effect in Hawaii absent Act 257, requires the lessee dealer to pay a monthly rent, consisting of an escalating percentage of the dealer's gross margin on actual, rather than estimated, gasoline sales. For instance, the rent would be calculated as 18% of the gross margin up to $18,000; 32% of the portion between $18,000 and $28,000; and 38% of the portion over $28,000. In contrast, Act 257 establishes a maximum regulated rent of 15% of gross margin.

The maximum rents Chevron projects it could receive under the statutory scheme imposed by Act 257 totals $6,126,646 for 1998. Chevron's projected expenses total $6,292,855, exceeding Chevron's projected rental income by $166,209. Chevron concedes, however, that it has not fully recovered its expenses relating to dealer stations (including ground lease rents, real property taxes, ordinary maintenance and depreciation) from rent in any state in the last 20 years.

Instead, Chevron relies on supply contracts to earn a profit. Dealers who choose to rent a station from Chevron must, as a condition of their lease, agree to purchase from Chevron all of the fuel necessary to satisfy demand at that station for Chevron gasoline. The price under the supply

contract is unilaterally set by Chevron. Both the lease agreement and the supply contract permit the dealer to transfer his or her occupancy rights upon obtaining Chevron's written consent and paying a transfer fee set by Chevron. Act 257 does not prohibit such transfers.

In conjunction with the alienability of the leaseholds, the parties stipulated to the following facts:

> 34. The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act 257, assuming Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment.
>
> 35. Assuming everything else remains equal, the market value of the lessee-dealer leasehold reasonably could be expected to increase as the amount of the rent payable decreases.

Based largely on these facts, Chevron moved for summary judgment on its takings claim.[2] Chevron argued that Act 257 effects a regulatory taking because it fails to substantially advance a legitimate state interest. Chevron also maintained that Act 257 prevents the company from receiving a just and reasonable return. Finally, Chevron contended that Act 257 is unconstitutional because it neither provides individualized consideration, nor contains a mechanism for obtaining relief from confiscatory rent

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[2] Chevron's other three claims (42 U.S.C. § 1983, due process and equal protection) were dismissed without prejudice by stipulation of the parties and are not at issue in this appeal.

cap provisions. Because the district court resolved the first argument in Chevron's favor, it declined to reach the other two.

On appeal, the State challenges both the standard used by the district court to evaluate Chevron's regulatory taking claim and the court's application of that standard in the summary judgment context.

II

"States have broad power to regulate . . . the landlord-tenant relationship . . . without paying compensation for all economic injuries that such regulation entails." *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 440, 73 L. Ed. 2d 868, 102 S. Ct. 3164 (1982). When a landowner decides to rent his land to tenants, the government may place ceilings on the rents the landowner can charge. *See, e.g., Pennell v. San Jose,* 485 U.S. 1, 11-12, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988). "While property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922).

The question in this case is whether Act 257 goes too far. To analyze that question, the district court concluded that "the appropriate inquiry is whether [Act 257] substantially advances a legitimate state interest." In reaching this conclusion, the court explicitly rejected the more deferential standard urged by the State. The State argues that the courts should look only to whether "the

Legislature rationally could have believed the Act would substantially advance a legitimate government purpose."[3]

To support this position, the State relies on a footnote in Chief Justice Rehnquist's dissenting opinion in *Keystone Bituminous Coal Association v. DeBenedictis,* 480 U.S. 470, 94 L. Ed. 2d 472, 107 S. Ct. 1232 (1987):

> Our inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation. When considering the Fifth Amendment issues presented by Hawaii's Land Reform Act, we noted that the Act, "like any other, may not be successful in achieving its intended goals. But 'whether in fact the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature rationally could have believed that the [Act] would promote its objective.'" *Hawaii Housing Authority v. Midkiff,* 467 U.S. 229, 242, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984).

Keystone, 480 U.S. at 511 n.3 (alterations in original). The State's reliance on this quote is unsound for two reasons. First, as the district court correctly noted, *Midkiff* dealt with a physical taking, rather than a regulatory one. In a physical taking, the government exercises its eminent domain power to take private property for "public use." Importantly, the government intends to take the property and is willing to pay compensation to the landowner. We

[3] Both the test used by the district court and that suggested by the State require a legitimate state interest. In this case, the district court found that the purpose of Act 257 is to "reduce gasoline prices for Hawaii's consumers." On appeal, the parties do not contest this finding. Likewise, the parties do not dispute the legitimacy of this interest.

have recognized that a more deferential standard applies in those circumstances. *See Richardson v. City and County of Honolulu,* 124 F.3d 1150, 1158 (9th Cir. 1997), *cert. denied,* 525 U.S. 871, 119 S. Ct. 168, 142 L. Ed. 2d 137 (1998) ("We see nothing inconsistent in applying heightened scrutiny when the taking is uncompensated, and a more deferential standard when the taking is fully compensated."); *see also Hall v. City of Santa Barbara,* 833 F.2d 1270, 1280 n.25 (9th Cir. 1986) ("It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.").

Second, the State's argument is foreclosed by our decision in *Richardson.* In *Richardson,* we established that land use regulations, including rent control ordinances like Act 257 that permit the capture of a premium, do not effect a taking if the regulation "substantially furthers a legitimate state interest." *Richardson,* 124 F.3d at 1164; *see also Keystone,* 480 U.S. at 485 ("Land use regulation can effect a taking if it 'does not substantially advance legitimate state interests, . . . or denies an owner economically viable use of his land.'") (quoting *Agins v. Tiburon,* 447 U.S. 255, 260, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980)).

III

While we recognize the concurring opinion's dissatisfaction with our application of the "substantially advances" test, we do not believe that our holding today either expands *Richardson* or contravenes Supreme Court precedent.

Relying on *Pennell v. City of San Jose,* 485 U.S. 1, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988), the concurrence asserts that rent control can ordinarily only be challenged as violative of due process, rather than as a regulatory taking. We read *Pennell* differently. In that case, a landlord challenged the constitutionality of a city rent control ordinance on three grounds: (1) the Takings Clause; (2) Due Process; and (3) Equal Protection. *See id.* at 4. The Court summarized the Takings Clause claim as follows:

> § 5703.28 of the Ordinance establishes the seven factors that a hearing officer is to take into account in determining the reasonable rent increase. The first six of these factors are all objective, and are related either to the landlord's costs of providing an adequate rental unit, or to the condition of the rental market. Application of these six standards results in a rent that is "reasonable" by reference to what appellants contend is the only legitimate purpose of rent control: the elimination of "excessive" rents caused by San Jose's housing shortage. When the hearing officer then takes into account "hardship to a tenant" pursuant to § 5703.28(c)(7) and reduces the rent below the objectively "reasonable" amount established by the first six factors, this additional reduction in the rent increase constitutes a "taking."

Id. at 9.

The Takings Clause claim in *Pennell* was not based on the mere existence of rent control, but was instead dependent on the hardship provision. Indeed, because rent control is not a per se taking, *see FCC v. Florida Power Corp.,* 480 U.S. 245, 252, 94 L. Ed. 2d 282, 107 S. Ct. 1107 (1987), the landlord had to argue why this particular rent

control ordinance effected a taking. To do so, he focused on the hardship provision, as the other factors apparently established a reasonable rent. The Court neither explicitly nor implicitly approved or disapproved of the landlord's argument. In fact, the Court declined to reach the merits of the Takings Clause claim because the hardship provision had never been applied. *See Pennell,* 485 U.S. at 9-10. The Court did proceed to analyze the landlord's remaining constitutional arguments. It did not, however, intimate in any way that rent control provisions should *only* be analyzed under the Due Process Clause. Rather, the Court determined that the Takings Clause claim was premature and then analyzed the Due Process Clause claim under the Due Process "reasonableness" test.

Moreover, to the extent that "something else" is required to challenge a rent control ordinance under the Takings Clause, the existence of the premium in this case suffices. The stipulated possibility that an incumbent dealer will be able to capture the value of the decreased rent in the form of a premium separates Act 257 from an ordinary rent control situation, where such a transfer is prohibited.

Logically, it makes far more sense for us to analyze Chevron's regulatory takings claim under the Takings Clause test than it does to review it under the Due Process Clause test. Chevron raised a Due Process Clause claim in its First Amended Complaint, but chose not to move for summary judgment on that claim. Once the district court in this case granted Chevron's summary judgment motion on the Takings Clause claim, Chevron dismissed its remaining claims without prejudice. Thus, there is no Due Process claim for us to review, even if we were so inclined.

The concurring opinion also downplays the significance of the Supreme Court's language in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). Although the Court in *Yee* did not conclusively announce the applicable test for a regulatory takings challenge to a rent control statute, it did suggest that the possibility of a premium similar to the one in this case "might have some bearing on whether the ordinance causes a regulatory taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* at 530. The Court then cited *Nollan v. California Coastal Commission,* 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987), which employs the "substantially advances" test.

The *Yee* Court went slightly further than in *Pennell* and held that the facial regulatory takings challenge was ripe. *See Yee,* 503 U.S. at 534. The Court did not reach the merits of the regulatory takings claim, however, because it concluded that the issue was not fairly presented in the certiorari petition. *See id.* at 537. In reaching that conclusion, the Court noted that "were we to address the issue here, we would apparently be the first court in the Nation to determine whether an ordinance like this one effects a regulatory taking." *Id.* at 538.

Although the Court recognized the novelty of the regulatory takings claim, it did not take any position on its merits. The ordinance in *Yee* is very similar to Act 257, in that the transfer of the mobile homes in *Yee* and the service station leaseholds here both create the possibility of a one-time transfer of wealth in the form of a premium that inures to incumbent lessees. Had the Court in *Pennell* rejected a regulatory takings challenge such as the one

posed by Chevron in the instant case, as the concurring opinion suggests, the Court in *Yee* would not have needed to expressly decline to reach the issue. We believe that the Court's treatment of the regulatory takings issue in *Yee* further undermines the concurrence's reading of *Pennell*.

City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687, 143 L. Ed. 2d 882, 119 S. Ct. 1624 (1999), gives additional support to the application of the "substantially advances" test to Chevron's Takings Clause claim. Although the Court recognized that it has not provided a "thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions," it noted that the jury instructions given by the trial court regarding the "substantially advances" test were consistent with the Court's previous general discussions of regulatory takings liability. *Id.* at 704. As support for this statement, the Court cited several land use regulatory takings cases, including *Yee*. *See id.* It is apparent to us that the Court viewed the rent control ordinance in *Yee* in the same manner as the land use regulations in the other cases. It is further apparent to us that when challenged as a regulatory taking, each is subject to the same "substantially advances" test.

We have great difficulty finding Supreme Court precedent to support the concurring opinion's assertion that rent control should be viewed differently than other land use regulations. *Accord Santa Monica Beach, Ltd. v. Superior Court*, 19 Cal. 4th 952 968 P.2d 993, 1021 (Cal. 1999) (Baxter, J., dissenting) ("We cannot assume that decisions upholding other forms of price control are authority for rejecting a takings clause challenge to a rent control ordinance.").

The concurring opinion also does not satisfactorily explain how to deal with *Richardson*. *Richardson* is the law of our circuit and has conclusively answered the question of what test should be applied in this case. Nevertheless, the concurring opinion attempts to avoid the holding of *Richardson* by inventing a "certainty" requirement that does not exist. The concurrence would limit the "substantially advances" test to cases in which "the existence of the premium capture is essentially beyond dispute." We do not believe that *Richardson* may faithfully be read so narrowly.[4]

Finally, we note that other federal cases have applied the "substantially advances" test in considering a regulatory takings challenge to a rent control ordinance. *See Federal Home Loan Mortgage Corp. v. New York State Div. of Hous. and Community Renewal*, 83 F.3d 45, 48 (2d Cir. 1996) (concluding that rent stabilization law does not constitute either physical or regulatory taking); *Greystone Hotel Co. v. City of New York*, 13 F. Supp. 2d 524, 527-29 (S.D.N.Y.) (concluding that rent stabilization provision substantially advanced a legitimate state interest and thus did not effect a regulatory taking); *Adamson Cos. v. City of Malibu*, 854 F. Supp. 1476, 1501-02 (C.D. Cal. 1994) (concluding that city's mobile home rent control ordinance was substantially related to a legitimate interest).

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[4] We also do not believe that our decision today expands the holding of *Richardson*. We save for another day the question of whether the "substantially advances" test applies outside the context of rent control statutes that permit the capture of a premium.

In sum, we disagree with the concurrence's position that we should apply the "reasonableness" test to evaluate Chevron's regulatory takings claim. The correct test is "whether the legislation substantially advances a legitimate state interest," as discussed above, as suggested by the Supreme Court in *Yee*, as used by the district court in this case, and as established by this court in *Richardson*.

IV

Although the district court applied the correct standard, it should not have granted summary judgment. Notwithstanding the fact that both sides moved for summary judgment and agreed that summary judgment was appropriate one way or the other, genuine issues of material fact remain.[5]

We review a district court's grant of summary judgment de novo. *See Balint v. Carson City*, 180 F.3d 1047, 1050 (9th Cir. 1999) (en banc). We determine, viewing the evidence in the light most favorable to the nonmoving

[5] At least one court has held that, under similar circumstances involving cross-motions for summary judgment, a party that failed to raise the existence of genuine issues of material fact before the district court waived the right to do so on appeal. *See Shrink Missouri Gov't PAC v. Maupin*, 71 F.3d 1422, 1423 (8th Cir. 1995). Even then, however, the court proceeded to analyze whether genuine issues of material fact remained. The better-reasoned approach holds that the district court is responsible for determining whether the requirements of Federal Rule of Civil Procedure 56 are met, whether or not the parties believe that they are. *See, e.g.*, William W Schwarzer et al., *The Analysis and Decision of Summary Judgment Motions*, 139 F.R.D. 441, 499 (Feb. 1992) ("The filing of cross-motions does not ensure that summary judgment is in order.").

party, whether the district court correctly applied the relevant substantive law and whether there are any genuine issues of material fact. *See id.* Because Chevron challenges Act 257 on its face, rather than as applied, Chevron bears the burden of proving by a preponderance of the evidence that the regulation does not substantially advance a legitimate state interest. *See City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 700-01, 143 L. Ed. 2d 882, 119 S. Ct. 1624 (1999).

A

The State argues here that Chevron was not entitled to summary judgment because the district court ignored genuine issues of fact raised by the affidavit of its expert economist, Dr. Keith Leffler. Chevron, in its moving papers, relied solely on the stipulated fact that an existing dealer may be able to sell his leasehold at a premium that derives from the increased value of the dealer's leasehold interest due to the reduced rent imposed by Act 257. Based on this possible premium transfer, Chevron argued that the benefits of Act 257 will inure to the incumbent dealer, rather than to consumers. Thus, according to Chevron, Act 257 does not substantially advance its purpose of lowering gasoline prices.

The State relied on Dr. Leffler to rebut Chevron's argument. In his affidavit, Dr. Leffler asserted that Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline market in Hawaii and thereby benefit consumers. This is so, according to Dr. Leffler, because lower monthly rent payments reduce a dealer's cost of continued operation, meaning more dealers are likely to stay in business. The presence of

more dealers means a greater supply of fuel to consumers and a greater supply leads to lower prices. Therefore, Dr. Leffler predicted that the rent cap would act to lower retail gasoline prices. Although Dr. Leffler acknowledged that an oil company could raise the wholesale cost of gasoline to dealers in order to make up for lost rent, he believed that wholesale oil suppliers would be unlikely to do so because such action would lead directly to reductions in volume as dealers would react by raising their street price. He also believed that while a premium transfer was possible, an incumbent dealer could not be expected to capture the net present value of the reduced rent because the net present value would depend on too many unknown variables, such as the oil company's rent policy, the future level of gasoline margins, and the sales of goods other than gasoline. Even if new lessee dealers could estimate the present value of rent reductions accurately, Dr. Leffler stated that any cost reductions would be fully captured by incumbent dealers only if the market for the sale of lessee dealer rights was perfectly competitive. Relying on the stipulated facts, which indicate that less than three sales of dealer rights occur per year, Dr. Leffler concluded that the market is relatively thin, rather than perfectly competitive. Finally, because Act 257 encourages dealers to stay in business longer by lowering fixed costs, Dr. Leffler asserted that Act 257 will benefit consumers even if the premium is fully captured.

In response to Dr. Leffler, Chevron proffered an affidavit from its own expert economist Dr. John Umbeck. Dr. Umbeck's opinion differs significantly from that of Dr. Leffler. Dr. Umbeck believes that Act 257 will reduce the net present value of an oil company's rental revenue and thereby discourage oil companies from building new

stations or maintaining old ones. Accordingly, Dr. Umbeck asserted that Act 257 will actually increase the concentration of Hawaii's gasoline market, rather than decrease it. Because Dr. Umbeck believes that there will be fewer stations in the long run, he states that the demand facing surviving dealers will increase, thus motivating and allowing them to raise fuel prices. Finally, Dr. Umbeck disputes Dr. Leffler's conclusion that the market for the sale of lessee dealer rights is thin. Dr. Umbeck believes that the premium value of the capped rent will be fully captured by the incumbent dealer.

The conflicting affidavits establish that genuine issues of fact remain as to whether Act 257 will result in lower gasoline prices. Whether, and to what extent, Chevron will raise its wholesale price of fuel to compensate for lost rent, and whether, and to what extent, incumbent dealers will capture the value of the capped rent in the form of a premium upon transfer of the leasehold, remain as unanswered questions. Moreover, to the extent that the district court purported to answer these questions, such resolution was premature.[6]

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[6] That the district court engaged in improper fact-finding is apparent from its summary judgment order. For instance, the court found, despite evidence to the contrary, that "[b]ecause oil companies can simply raise their wholesale prices to the same extent that rent decreases, the dealer is likely to be unaffected by the rent cap, and gas prices will remain unchanged."

Because this case will be tried to the court, rather than a jury, the question arises whether it was improper for the district court to engage in fact-finding, since it will eventually be called upon to perform that very task. This court has held that if the parties agree that all of the underlying material facts are reflected in the written record, a judge may decide factual issues and essentially convert cross-motions for

(Continued on following page)

Admittedly, these are questions of predictive fact, rather than historical fact. Nevertheless, summary judgment is no more appropriate when predictive facts are disputed. *See Washington Post Co. v. United States Dep't of Health and Human Servs.*, 275 U.S. App. D.C. 101, 865 F.2d 320, 326 (D.C. Cir. 1989) (reversing summary judgment based on conflicting experts' predictions). In *Washington Post*, the plaintiff sought access under the Freedom of Information Act, 5 U.S.C. § 552, to certain financial

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summary judgment into submission of the case for trial on the written record. *See Starsky v. Williams*, 512 F.2d 109, 111 (9th Cir. 1975). The court noted, however, that that result was justified by the unique circumstances of that case. *See id.* Moreover, the court later cautioned that such fact-finding is not appropriate on an undeveloped factual record. *See TransWorld Airlines, Inc. v. American Coupon Exchange, Inc.*, 913 F.2d 676 (9th Cir. 1990). There, the court stated:

> [W]here the ultimate fact in dispute is destined for decision by the court rather than by a jury, there is no reason why the court and the parties should go through the motions of a trial if the court will eventually end up deciding on the same record. However, just as the procedural shortcut must not be disfavored, courts must not rush to dispose summarily of cases – especially novel, complex, or otherwise difficult cases of public importance – unless it is clear that more complete factual development could not possibly alter the outcome and that the credibility of the witnesses' statements or testimony is not at issue. Even when the expense of further proceedings is great and the moving party's case seems to the court quite likely to succeed, speculation about the facts must not take the place of investigation, proof, and direct observation.

Id. at 684-85. Although the parties in this case submitted a Stipulation of Facts, there is no clear indication, as there was in *Starsky*, that all of the relevant facts are contained in the written record. In fact, in the Stipulation itself, the parties clearly reserve the right to rely on other statements. Therefore, we hold that the district court erred in resolving factual disputes at this stage, even though it must do so later.

disclosure forms filed by National Cancer Institute consultants. *See* 865 F.2d at 321. The district court granted summary judgment in favor of the government. On appeal, the D.C. Circuit held that a genuine issue of material fact existed as to the effect of disclosure on the government's ability to obtain the information it needed from its scientist-consultants. *See id.* In so holding, the court reviewed the evidence in the record and concluded that the conflicting affidavits created a genuine issue of fact regarding the consequences of disclosing the sought-after information. The court explicitly rejected the trial court's explanation that resolution of this dispute involves an analysis of the potential, hypothetical impairment the government might suffer. . . . Due to the nature of the inquiry, there is no definitive proof that may be adduced by either side in support of their respective contentions. At best, the parties may provide the Court with speculation from individuals who speak with varying degrees of authority.

Id. at 324. The court held that the district court had "short-circuited the fact-finding process." *Id.* at 326. The court further explained that:

> "Factual" issues like those presented here are rarely susceptible to definitive proof. Rather, "factual" issues that involve predictive facts almost always require a court to survey the available evidence, to credit certain pieces of evidence above others, and to draw cumulative inferences until it reaches a judgmental conclusion. In the end, the court makes its best assessment about what is most likely to happen in the future. In such an inquiry, the ultimate "facts" in dispute are most successfully

> approached when all relevant evidentiary underpinnings are fully developed.

Id. at 326.

As in *Washington Post*, the experts' conflicting predictions here created genuine issues of fact. A proper evaluation of Act 257 depends upon further development of the experts' underlying facts. Although both experts based their opinions on the stipulated facts, they also rely on other unproven factual assumptions. In order to determine whose predictions are more accurate, there needs to be a better understanding of the competitiveness of the market for the sale and purchase of lessee dealer rights and the elasticity of demand for gasoline. This can be attained only through additional factual development and cross-examination of the parties' expert witnesses. Cross-examination is particularly appropriate here because it is necessary for the court to evaluate the witnesses' credibility in order to evaluate their expert opinions. By adopting the predictions of Chevron's expert without the benefit of this needed information, the district court "short-circuited the fact-finding process."

B

Issues of fact do not preclude summary judgment unless they are material to the substantive claim at issue, that is, unless they "might affect the outcome of the suit under the governing law." *Moreland v. Las Vegas Metro. Police Dep't*, 159 F.3d 365, 369 (9th Cir. 1998) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)). The factual disputes here are material only if their resolution would alter

whether Act 257 "substantially advances a legitimate state interest."

In order to determine materiality, we first determine what is required by the "substantially advances" test. Obviously, a connection of some sort must be established between Act 257's means (that is, a maximum regulated rent) and the intended end (lower gas prices). The question arises whether the mere possibility that the rent cap will not achieve its purpose is sufficient to destroy this nexus. The district court, relying on *Richardson*, believed this to be the case. If that belief is correct, the factual disputes are not material because the parties concede that that possibility exists. If, however, the standard requires a closer evaluation of the likelihood that the means will achieve the end, then these disputes are material.

In *Richardson*, we held that a Honolulu ordinance that imposed a cap on rent for land under condominium units was an unconstitutional regulatory taking. The court concluded that:

> The absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu. Incumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium. The price of housing ultimately will remain the same. The Ordinance thus effects a regulatory taking.

124 F.3d at 1166. Importantly, our conclusion in *Richardson* was based on the district court's findings that incumbent

owners *will* charge a premium and that the price of housing *will* remain the same. Apparently, these findings were not contested on appeal.

Whether the price of gasoline will remain the same here is vigorously contested. The mere possibility that it will does not satisfy Chevron's burden of proving that Act 257 does not substantially further its purpose. Logically, there must be a determination of the likelihood of that possibility. Otherwise, regulatory legislation would be unconstitutional any time it was not absolutely guaranteed to achieve its purpose. Would a statute that was 95% likely to be effective fail to substantially advance its interest simply because there was a 5% chance that it would not achieve its goal? What if the statute was 99% effective? Surely the 1% chance that it would be ineffective does not, as a matter of law, mean that the statute does not "substantially advance" its purpose.

Not only does such a reading of *Richardson* fail the logic test, but it also fails to consider the language. Had the test been intended to require an absolute cause-and-effect relationship, the word "substantially" would have no meaning. For these reasons, the district court improperly relied on *Richardson* to conclude that the absence of a mechanism that prevents a premium transfer necessarily destroys the constitutionally-required connection.

The State argues that the existence of a premium is not relevant. As discussed in Section III above, however, the Supreme Court recognized this relevance in *Yee,* 503 U.S. at 530. While the existence of a premium transfer had nothing to do with a physical taking, the Court stated that "this effect might have some bearing on whether the ordinance causes a regulatory taking, as it may shed some

light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* The Supreme Court did not hold that the possibility of a premium transfer necessarily defeated that connection; it recognized only that it "might have some bearing" on it. *Id.*

The question remains as to what exactly the connection does require. In a candid statement, the Supreme Court recently acknowledged that is has not provided a "thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions. . . . " *City of Monterey,* 526 U.S. at 704. In *City of Monterey,* the Court affirmed judgment in favor of Del Monte Dunes, a property owner who contended that the city's repeated rejections of its plans for development effected an unconstitutional regulatory taking. The Court held that the case was properly submitted to a jury. Although the Court refused to consider the City of Monterey's challenge to the jury instructions, as the City itself had proposed their essence, the Court nonetheless noted that the following jury instructions were consistent with the Court's previous discussions of regulatory takings liability:

> "Public bodies, such as the city, have the authority to take actions which substantially advance legitimate public interests. . . . So one of your jobs as jurors is to decide if the city's decision here substantially advanced any such legitimate public purpose."
>
> "The regulatory actions of the city or any agency substantially advance a legitimate public purpose

> of the action bears a reasonable relationship to that objective."
>
> "Now, if the preponderance of the evidence establishes that there was no reasonable relationship between the city's denial of the . . . proposal and legitimate public purpose, you should find in favor of the plaintiff. If you find that there existed a reasonable relationship between the city's decision and a legitimate public purpose, you should find in favor of the city. As long as the regulatory action by the city substantially advances their [sic] legitimate public purpose, . . . its underlying motives and reasons are not to be inquired into."

526 U.S. at 700-01. Based on these instructions, a challenged regulatory action "substantially advances" its interest if it bears a reasonable relationship to that interest.

Understanding what the "substantially advances" test requires also depends to some extent on understanding what it does not require. In *City of Monterey,* the Court declined to extend the "rough proportionality" test beyond the special context of exactions – land use decisions conditioning approval of development on the dedication of property to public use. *See id.* at 702-03. Thus, *City of Monterey* teaches that a reasonable relationship does not depend on the State's action being roughly proportional to its asserted interests.

Whether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on whether it will in fact lead to lower fuel prices. The factual issues that remain in dispute are material to the ultimate determination required in this action. We hold that the

district court should not have granted summary judgment on Chevron's first argument.

C

Because the judgment can be affirmed on any basis supported in the record, we briefly consider the second and third arguments made by Chevron in its summary judgment motion, even though the district court did not. There are two ways in which a party can challenge a regulatory action on its face. The first has been thoroughly discussed above. The second depends on whether the regulation deprives an owner of the economic viability of property. An owner is not denied the economic viability of property, unless there remains no permissible or beneficial use for that property after the regulatory action. *See City of Monterey,* 526 U.S. at 700 (quoting jury instruction to that effect). Chevron has made no such showing. In fact, the evidence shows that Act 257 allows Chevron to charge approximately $1.1 million more than it would otherwise have charged under its own rental program. Although this evidence may be useful to Chevron in demonstrating the ineffectiveness of Act 257, it belies its claim of loss of economic viability.

Chevron also argues that Act 257 is unconstitutional because it fails to provide for any individualized consideration and contains no mechanism for obtaining relief from the confiscatory rent limitation provisions. In support of this argument, Chevron relies on two state court cases and one of the two district court orders in *Richardson. See Cromwell Assocs. v. Mayor and Council of Newark,* 211 N.J. Super. 462, 511 A.2d 1273, 1275 (N.J. Super. Ct. Law Div. 1985); *Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129,

550 P.2d 1001, 1028-1033, 130 Cal. Rptr. 465 (Cal. 1976); *Richardson v. City and County of Honolulu,* 802 F. Supp. 326, 336-37 (D. Haw. 1992) ("*Richardson II*"). The precedents established in these cases do not bind us. Although addressed by the district court in *Richardson II,* in *Richardson* we declined to reach the issue on appeal. Likewise, the Supreme Court in *Permian Basin Area Rate Cases,* 390 U.S. 747, 770, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968), refused to decide whether individualized consideration and administrative relief were "constitutionally imperative." Earlier Supreme Court cases, however, have suggested that there are no such constitutional requirements. In *Bowles v. Willingham,* 321 U.S. 503, 518, 88 L.Ed. 892, 64 S. Ct. 641 (1944), the Court stated that otherwise valid price-fixing was not improper because it was on a class rather than an individual basis. Justice Brandeis stated for a unanimous Court in *Phillips v. Commissioner,* 283 U.S. 589, 596-97, 75 L.Ed. 1289, 51 S. Ct. 608 (1931), that "where only property rights are involved, mere postponement of the judicial enquiry is not a denial of due process, if the opportunity given for the ultimate judicial determination of the liability is adequate." As evidenced by the instant action, Chevron was not denied an opportunity to seek judicial review of Act 257.

Finally, the cases relied upon by Chevron – *Cromwell Associates, Birkenfeld,* and *Richardson II* – are distinguishable because they involved ordinances that regulated a landlord's sole source of revenue. Imposing a maximum rent removed the only mechanism by which a landlord could increase revenues in the event of an increase in costs. Chevron's lessee dealer stations provide Chevron

with two sources of revenue. For the past 20 years, Chevron has relied on its lessee dealers' contractually-required purchase of gasoline to assure a reasonable rate of return on its service stations. Act 257 does not regulate this revenue source. Accordingly, Act 257's failure to contain an administrative relief provision does not result in a facial taking.

V

Genuine issues of material fact exist as to whether Act 257 will benefit consumers. Specifically, the record contains conflicting evidence as to whether incumbent dealers will capture a premium based on the increased value of their leaseholds due to the imposition of a maximum permissible regulated rent, thereby depriving new dealers and consumers from reaping the benefits of Act 257. Questions also remain as to whether oil companies will raise the wholesale price of fuel and thereby unilaterally offset the benefits of the Act. Because resolution of these factual issues is necessary to determine whether Act 257 substantially advances, or bears a reasonable relationship to, the State's interest in lowering gasoline prices, the district court erred in granting summary judgment. Summary judgment is likewise inappropriate on the other two grounds urged by Chevron.

We VACATE the judgment of the district court and REMAND for further proceedings consistent with this opinion.

CONCUR BY: William A. Fletcher

CONCUR: W. FLETCHER, Circuit Judge, concurring in the judgment:

I disagree with the majority's analysis. Plaintiff Chevron challenges Hawaii Act 257, a rent control law limiting the amount an oil company can charge a dealer who leases a service station from the company. In a motion for summary judgment, Chevron argued that Act 257 is unconstitutional. The district court found Act 257 unconstitutional, granted Chevron's motion, and entered final judgment for Chevron. Defendant Cayetano timely appealed. We reverse and remand.

For the reasons that follow, I concur in the reversal of the grant of summary judgment to Chevron. I disagree, however, with the majority's rationale and with the task the majority has set for the district court on remand.

I

There are two distinct tests of constitutionality potentially applicable to Act 257. The first is a "reasonableness" test normally applied to rent control laws. The second is a "substantially advances a legitimate state interest" test normally applied to zoning and land use regulations. Relying on our earlier decision in *Richardson v. City and County of Honolulu,* 124 F.3d 1150 (9th Cir. 1997), the majority analyzes Act 257 under the second test. The problem in this case is not determining whether the majority has properly applied that test. The problem, rather, is determining whether the test should be applied at all.

An ordinary rent control law is constitutionally indistinguishable from a price control law. Rent control involves a price charged for real property, just as price control involves a price charged for personal property. The constitutional test for ordinary rent and price control laws

is the same, regardless of whether the laws are challenged under the Due Process Clause or the Takings Clause. The test has been variously formulated, but it essentially requires that the law be "reasonable" and "not confiscatory." A few examples illustrate the point.

In *Pennell v. City of San Jose,* 485 U.S. 1, 11, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988), the Supreme Court cited a rate regulation case in upholding a municipal rent control ordinance challenged under the Due Process Clause. The Court upheld the ordinance because it was not "'arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . .' *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-770, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968)." In *FCC v. Florida Power Corp.,* 480 U.S. 245, 253, 94 L. Ed. 2d 282, 107 S. Ct. 1107 (1987), the Court upheld a rate regulation challenged under the Takings Clause as "not confiscatory." Citing the same rate regulation case as *Pennell,* it wrote that a regulation is permitted under the Constitution to "'limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.'" *Id.* (citing *Permian Basin Area Rate Cases,* 390 U.S. at 769). In *In re Permian Basin Area Rate Cases,* the 1968 case cited in both *Pennell* and *FCC v. Florida Power,* the Court upheld a rate set by the Federal Power Commission without specifying whether the challenge was brought under the Due Process or Takings Clause: "any rate selected by the Commission from the broad zone of reasonableness . . . cannot properly be attacked as confiscatory." 390 U.S. at 770. In *Bowles v. Willingham,* 321 U.S. 503, 517, 88 L.Ed. 892, 64 S. Ct. 641 (1944), the Court upheld a federal rent control law after applying the same test as for a price control law: "Of

course, price control, the same as other forms of regulation, may reduce the value of the property regulated. But . . . that does not mean that the regulation is unconstitutional." Finally, in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585, 86 L.Ed. 1037, 62 S. Ct. 736 (1942), the Court upheld a rate regulation challenged under the Due Process Clause because it was "reasonable" and "not confiscatory."

Beginning with *Agins v. City of Tiburon*, 447 U.S. 255, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980), the Supreme Court developed a more stringent test of constitutionality for zoning and land use regulation cases. The zoning ordinance in *Agins* severely limited development of privately owned land in order to preserve open space for the community. The Court upheld the constitutionality of the ordinance against a regulatory taking challenge because the ordinance "substantially advanced legitimate state goals." *Id.* at 261. In *Nollan v. California Coastal Commission*, 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987), the California Coastal Commission required owners of a beachfront house to grant a public easement across their property as a condition for receiving a permit to rebuild the house. Citing *Agins*, the Court stated, "Our verbal formulations in the takings field have generally been quite different [from those applicable to due process]. We have required that the regulation 'substantially advance' the 'legitimate state interest' sought be achieved, not that the State *could rationally have decided* that the measure adopted might achieve the State's objectives." *Id.* at 834 n.3 (emphasis in original; citations and internal quotations omitted). The Court further required that the easement have a connection, or "essential nexus," to the harm that would be caused by rebuilding the house.

Absent such a nexus, the required conveyance of an easement to the public would be nothing more than "extortion." *Id.* at 837. Finally, in *Dolan v. City of Tigard*, 512 U.S. 374, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994), the city of Tigard, Oregon, required the owner of a commercial building to dedicate a portion of her property for parking and floodplain protection as a condition of receiving a permit to expand the building. The Court repeated the test from *Agins* and refined the *Nollan* "essential nexus" test. "A land use regulation does not effect a taking if it 'substantially advances legitimate state interests' and does not 'deny an owner economically viable use of his land.'" *Id.* at 385. Further, a "required dedication" from the landowner is constitutionally permissible if it bears a "rough proportionality" to the "nature and extent of the impact of the proposed development" for which the permit is sought. *Id.* at 391.

The Supreme Court has applied the "substantially advances a legitimate state interest" test of *Agins*, and its refinement in *Nollan* and *Dolan*, only in cases of severe zoning limitations on the use of land (*Agins*) and required dedications by landowners as a condition of receiving building permits (*Nollan* and *Dolan*). *See, e.g., City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 119 S. Ct. 1624, 1635-36, 143 L. Ed. 2d 882 (1999) ("We have not extended the rough proportionality test of *Dolan* beyond the special context of exactions – land-use decisions conditioning approval of development on the dedication of property to public use. . . . This Court has [not] provided . . . a thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions."). In two

cases, however, the Supreme Court has hinted that, in special circumstances, a rent control law might amount to a regulatory taking and might therefore be subject to the "substantially advances a legitimate state interest" test.

In 1988, the Court considered a San Jose, California, rent control ordinance in *Pennell v. City of San Jose,* 485 U.S. 1, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988). The Court made clear that the ordinance, considered as a whole, should be analyzed under the normal reasonableness test:

> The standard for determining whether a state price-control regulation is constitutional under the Due Process Clause is well-established: "Price control is 'unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . .'" *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-770, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968).

485 U.S. at 11 (citation omitted). Applying this test, the Court sustained the rent control ordinance, holding that it represented "a rational attempt to accommodate the conflicting interests of protecting tenants from burdensome rent increases while at the same time ensuring that the landlords are guaranteed a fair return on their investment." *Id.* at 13.

The plaintiffs also brought a Takings Clause challenge to a specific provision in the ordinance that appeared to require a direct wealth transfer to a particular tenant based on the poverty of that tenant. Under the ordinance, a landlord seeking a rent increase of more than 8% was required to go before a hearing officer who was authorized to consider, among other factors, individual hardship.

If the proposed increase above 8% constituted "'an unreasonably severe financial or economic hardship on a particular tenant,'" the increase could be denied. *Id.* at 6. The landlords contended that denial of a proposed increase on that ground would constitute a taking, but the Court refused to decide the challenge, or even to specify a test for deciding it, because the provision had never been applied and a decision would therefore be "premature." *Id.* at 9.

Next, in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992), the Court addressed a takings challenge to an Escondido, California, mobile home rent control ordinance brought by owners of a mobile home park. As background to their challenge, the park owners pointed out that, despite their name, mobile homes are not mobile; once placed in a park, only about one mobile home in 100 is ever moved. *See id.* at 523. The park owners also pointed to California's Mobilehome Residency Law, which severely limited their ability to terminate mobile home owners' tenancies or prevent transfer of tenancies to purchasers of the mobile homes. The park owners contended that the rent control ordinance, when viewed against this background, amounted to a physical taking of their property. *See id.* at 525. The Court rejected this contention.

The park owners further contended that the ordinance constituted a regulatory taking, but the Court refused to consider the issue because it was not included in the grant of certiorari. However, in rejecting the plaintiffs' claim of physical taking, the Court wrote the following:

> The effect of the rent control ordinance, coupled with the restrictions on the park owner's freedom to reject new tenants, is to increase significantly the value of the mobile home. This increased

value normally benefits only the tenant in possession at the time the rent control is imposed. . . . Petitioners are correct in citing the existence of this premium as a difference between the alleged effect of the Escondido ordinance and that of an ordinary apartment rent control statute. Most apartment tenants do not sell anything to their successors (and are often prohibited from charging "key money"), so a typical rent control statute will transfer wealth from the landlord to the incumbent tenant and future tenants. By contrast, petitioners contend that the Escondido ordinance transfers wealth only to the incumbent mobile home owner. This effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. See *Nollan v. California Coastal Comm'n.* But it has nothing to do with whether the ordinance causes a *physical* taking.

Id. at 530 (citation omitted).

A panel of this court in *Richardson* relied on this passage from *Yee* in evaluating a Honolulu rent control ordinance. The ordinance limited long-term ground rents for residential condominiums and allowed condominium-owners/ground-lessees to sell their condominiums, and their leaseholds, without restriction. It was clear that by selling their condominiums and leaseholds, the condominium owners could, like the mobile home owners in *Yee,* capture a premium representing the present value of the difference between the controlled rent for the ground lease and the open market rent that would be charged in the absence of the ordinance. Because of this one-time wealth

transfer to the current condominium owners, *Richardson* treated the ordinance as a regulatory taking and applied the "substantially advances a legitimate state interest" test from *Agins, Nollan* and *Dolan*: "A land use regulation . . . does not effect a taking if it substantially furthers a legitimate state interest and does not deny the landowner economically viable use of his land. *Dolan,* 512 U.S. at 385." 124 F.3d at 1164. *Richardson* then struck down the ordinance because the ability of the owner to capture the premium by selling the condominium at an open market price meant that the ordinance did not "substantially further its goal of creating affordable owner-occupied housing in Honolulu." *Id.* at 1166.

The panel today greatly expands the holding in *Richardson.* Following the Supreme Court's suggestion in *Yee, Richardson* held that the "substantially advances a legitimate state interest" test was applicable in a case where it was clear that there was a premium resulting in a one-time wealth transfer from the landlord to the tenant. Absent such a transfer, the ordinance in *Richardson* would have been subject to the reasonableness test normally applied to rent control ordinances. In deciding whether to apply the "substantially advances a legitimate state interest test," the majority in this case does not first ask how clear it is that such a premium will be captured by the lessee. Rather, it treats *Richardson* as creating a presumptive rule that rent control laws are to be evaluated under the "substantially advances a legitimate state interest" test rather than the reasonableness test: "We established in *Richardson* that land use regulations, including rent control ordinances like Act 257, do not effect a taking if the regulation 'substantially furthers a legitimate state interest.' *Richardson,* 124 F.3d at 1164." *Maj. Op.* at 11723.

When the majority says that "rent ordinances like Act 257" are subject to the "substantially advances a legitimate state interest" test, it appears to mean that the mere possibility of a premium capture by an incumbent tenant is enough to render a rent control ordinance "like Act 257." It writes, "The stipulated *possibility* that an incumbent dealer will be able to capture the value of the decreased rent in the form of a premium separates Act 257 from an ordinary rent control situation[.]" *Maj. Op.* at 11725 (emphasis added). But the possibility of premium capture exists under virtually all rent control ordinances. Even under ordinances under which subleasing and assigning are prohibited, subleasing and assigning (and resulting premium capture) are nonetheless often commonplace.

We do not know in this case whether the tenants will, in fact, capture a premium. But even without knowing this, the majority has determined that the "substantially advances a legitimate state interest" test should be used to test the constitutionality of Act 257. The majority might respond that it does not matter that, at the time of determining what test to apply, the Court does not know whether a premium will be captured. That is, if upon investigation it turns out that there is no captured premium, the ordinance will pass the test. In other words, no harm, no foul. The problem with this response is that the constitutional test applied by the majority is not phrased in terms of whether a premium is captured. Rather, the test asks whether the rent control ordinance "substantially advances a legitimate state interest." Premium capture by the tenant is only one of many ways in which an ordinance can fail that test. Thus, if it turns out that there is, in fact, no premium capture, an ordinance may nonetheless be

struck down because it fails for some other reason substantially to advance a legitimate state interest.

Even if our decision in *Richardson* was right, I believe that the majority is wrong to expand it beyond the category of cases in which the existence of the premium capture is essentially beyond dispute. I believe that in expanding the holding of *Richardson,* the majority's opinion undermines or even contradicts the Supreme Court's decisions in ordinary rent control cases such as *Pennell* and *Bowles v. Willingham,* as well as threatens its decisions in price control cases such as *FCC v. Florida Power* and the *Permian Basin Area Rate Cases.*

II

If the majority confined itself to *Richardson,* it would not be able to apply the "substantially advances a legitimate state interest" test to the facts of this case. Under the suggested analysis in *Yee,* and as I read *Richardson,* the prerequisite to the application of that test is that there be a clear capture of the premium resulting from the rent control ordinance. Because there is no clear showing in this case that the premium will be captured by the lessees, the prerequisite for applying the test does not exist.

The factual foundation in this case is provided by a lengthy Stipulation of Facts filed in the district court. Stipulations 26 and 27 state that Chevron dealers can sell their dealerships (and associated leaseholds), and that the selling price is not limited either by Chevron's dealer lease or supply contracts or by Act 257. However, such a sale is subject to two conditions. First, Stipulation 30 states that Chevron could object to the sale in "good faith," as that term is defined by Hawaii Revised Statute § 486H-1: "The

petroleum distributor shall not impose on a gasoline dealer by contract, rule, or regulation, whether written or oral, any standard of conduct that is not reasonable and of material significance to the franchise relationship." It is not clear from the materials available to us whether Chevron would be acting in good faith within this definition if it allowed a dealer to sell a dealership and leasehold only on condition that the premium resulting from Act 257 be passed on to the new dealer in calculating the sale price. Stipulation 34 suggests that such a condition might be in good faith: "The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act, assuming that Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment." Second, Stipulation 26 states that Chevron may require the payment of an unspecified "transfer fee" as a condition of permitting the sale of a dealership. It is not clear from the materials before us whether such a transfer fee could include the premium resulting from Act 257.

Further, Act 257 only limits the amount of rent Chevron can charge its lessee-dealers. Chevron derives its revenue from them not only through rent, but also through the wholesale price for gasoline. Stipulation 15 states that Chevron requires its dealers, as a condition of their lease, to purchase Chevron-branded gasoline directly from Chevron. Stipulation 17 states, "Chevron recovers its expenses and investment costs of lessee dealer stations (e.g., ground-lease rent, real property taxes, ordinary maintenance, and depreciation) in Hawaii and throughout the United States through two principal revenue streams – rental revenue and earnings on Chevron gasoline sold

through the stations." Stipulation 9 states, "Under a supply contract, the lessee-dealer markets Chevron motor fuels, which the lessee dealer buys from Chevron, *at a price unilaterally determined by Chevron.* Chevron does not enter into a dealer lease unless the dealer simultaneously executes a supply contract with Chevron" (emphasis added).

It is thus entirely within Chevron's power to prevent its lessee-dealers from capturing any premium resulting from Act 257. Chevron may have that power pursuant to its ability to object in good faith to a sale or to impose a transfer fee. Chevron certainly has that power pursuant to its ability unilaterally to increase the wholesale price of the gasoline to its dealers. Indeed, the district court specifically discussed Chevron's ability to charge more for its gasoline and thereby to capture the premium: "Defendant's expert fails to explain why the oil company would not increase the wholesale price to simply offset the decrease in rent. . . . Neither Defendants nor Defendants' expert have offered any reason why this is not a feasible, and even likely, result."

I recognize that the district court also stated that "the Act . . . allows incumbent dealers to capture the value of the decreased rent in the form of a premium," but the court made the statement to show why the Act was not likely to achieve its purpose of lowering retail gasoline prices rather than to justify the application of the "substantially advances a legitimate state interest" test. The question under *Richardson* is not whether the terms of the Act themselves allow – i.e., do not prohibit – capture of the premium; rather, the question is whether the Act creates a situation where we know the premium will, in fact, be captured. As the district court noted, the "feasible, even

likely, result" is that Chevron will take that premium for itself in the form of higher wholesale prices charged to its dealers.

III

I fear that under the majority opinion virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and that this test may invalidate many of these laws. I will not undertake an extended analysis of the economic and social effects of rent control laws. Suffice it to say that the virtually unanimous opinion of economists is that, except in unusual and short-lived circumstances, they often do not achieve their stated purposes. They result in the creation of large and unwieldy bureaucracies. They do not subsidize the truly needy – the homeless and those in public housing; rather, they subsidize those already able to pay for their own housing, including many who can easily pay an open market price. They interfere with the normal play of free market forces, thereby creating incentives that result in reduced supplies of housing, reduced maintenance and repairs on existing housing, increased housing code violations, and increased transportation inefficiencies when tenants change schools or jobs but remain in rent-controlled housing.

The question before the judiciary is not the advisability of rent control laws but rather their constitutionality. Ever since its retreat from economic substantive due process at the end of the 1930s, the Supreme Court has essentially left it to the other branches of government to decide, in their political wisdom, whether to adopt rent and price controls. The Supreme Court's hints in *Pennell*

and *Yee* may signal a willingness to rethink this long-ago retreat, but at this point the Court has not yet done so.

I am not sure whether, in *Richardson,* we properly interpreted the Court's hints in *Yee* in concluding that the "substantially advances a legitimate state interest" test used in zoning and land use regulation cases should have been applied to the rent control ordinance in that case. I am inclined to think that we did not. I am sure, however, that the majority in this case extends *Richardson* beyond current law.

IV

It is not clear that Hawaii's Act 257 will result in the capture of a premium representing a one-time wealth transfer to dealers currently leasing stations from Chevron. Thus, even assuming that *Richardson* is good law, Act 257 should not be analyzed under the "substantially advances a legitimate state interest" test. Rather, Act 257 should be analyzed under the reasonableness test applicable to ordinary rent and price control laws. While I agree with the majority that the summary judgment granted to Chevron should be reversed, I disagree with the majority about the district court's task on remand. In my view, the district court should apply the reasonableness test applied – until today – to ordinary rent and price control laws.

CHEVRON U.S.A. INC., Plaintiff, vs. BENJAMIN J. CAYETANO, ET AL., Defendants.

CIV. NO. 97-00933 ACK

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII

57 F. Supp. 2d 1003; 1998 U.S. Dist. LEXIS 22243

November 10, 1998, Decided
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JUDGES: Alan C. Kay, Chief United States District Judge.

OPINION BY: Alan C. Kay

OPINION:

ORDER RE: MOTIONS FOR SUMMARY JUDGMENT

SYNOPSIS

The Court is mindful of the strongly felt concerns of the legislature that Hawaii's consumers are paying too much for gasoline. However, the Court finds that Act 257 as crafted fails to substantially further this legitimate state interest, and therefore effects an unconstitutional taking.[1] Section 3(c) of Act 257, which limits rents that an oil company may charge its lessee dealers, fails to benefit dealers and consumers for two principal reasons. First, similar to the condominium tenants under the rent control ordinance declared unconstitutional in *Richardson v. City and County of Honolulu,* incumbent dealers are able to capture the value of reduced rent in the form of a premium upon sale of their leaseholds, and consequently, incoming lessee dealers are not benefitted by the Act. 124 F.3d 1150 (9th Cir. 1997), cert. denied, 119 S. Ct. 168, 142 L. Ed. 2d 137, 1998 WL 313049 (1998), and cert. denied, 119 S. Ct. 275, 142 L. Ed. 2d 227, 1998 WL 407121 (1998).[2] Second, since oil companies can offset rent reductions by increasing wholesale gasoline prices, they can unilaterally negate any benefit to be realized by dealers and consumers.

BACKGROUND

On June 21, 1997, the Hawaii Legislature, prompted by concerns regarding the relatively high price of gasoline charged to Hawaii consumers, enacted Act 257 of the Hawaii Revised Statutes. Act 257, inter alia, implements restrictions on gasoline manufacturers and jobbers in dealing with their retail dealers. Specifically, Section 3(c) of Act 257 ("the Act") restricts the amount of lease rent an

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[1] The Court notes the State of Hawaii has now pursued other means to rectify these concerns by filing suit against gasoline wholesalers in Hawaii, alleging, inter alia, they have engaged in price fixing.

[2] The Court notes that Act 257 was enacted before the Ninth Circuit Court issued its decision in *Richardson.*

oil company may charge a lessee dealer for use of a service station.

In response to the enactment of the Act, Plaintiff Chevron brought suit against Defendants Benjamin J. Cayetano, Governor of the State of Hawaii, and Margery S. Bronster, Attorney General of the State of Hawaii, challenging Section 3 of the Act as effecting an unconstitutional taking of Chevron's property in violation of the Fifth and Fourteenth Amendments of the United States Constitution. Section 3 of the Act reads, in pertinent part:

> (c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:
>
> (1) Such renewal [of the lessee-dealer's leasehold] shall not be scheduled more frequently than once every three years; and
>
> (2) Upon renewal [of the leasehold], the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen percent of the gross profit of product, excluding all related taxes by the dealer operated retail service station as defined in section 486H-1 and 486H-plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purpose of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail service station after all applicable taxes, excluding income taxes, are paid. The provisions

> of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.
>
> (d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.

Haw. Rev. Stat. § 486H-10.4 (1997).

On January 28, 1998, Plaintiff filed a motion for partial summary judgment on its Second Claim for Relief. On July 30, 1998, Defendants responded and filed a cross motion for summary judgment on all claims in Plaintiff's complaint. On August 19, 1998, and August 28, 1998, Plaintiff and Defendants each filed their respective replies. The Court heard oral arguments on September 8, 1998. Both parties agreed that this case should be decided one way or the other on summary judgment.

SUMMARY JUDGMENT STANDARD

Summary judgment shall be granted where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). One of the principal purposes of the summary judgment procedure is to identify and dispose of factually unsupported claims and defenses. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986).

The United States Supreme Court has declared that summary judgment must be granted against a party who fails to demonstrate facts to establish an element essential to his case where that party will bear the burden of proof of that essential element at trial. *See Celotex*, 477 U.S. at

322. "If the party moving for summary judgment meets its initial burden of identifying for the court the portions of the materials on file that it believes demonstrate the absence of any genuine issue of material fact [citations omitted], the nonmoving party may not rely on the mere allegations in the pleadings in order to preclude summary judgment." *T.W. Elec. Serv. v. Pacific Elec. Contractors Ass'n,* 809 F.2d 626, 630 (9th Cir. 1987).

Rather, Rule 56(e) requires that the nonmoving party set forth, by affidavit or as otherwise provided in Rule 56, specific facts showing that there is a genuine issue for trial. *See T.W. Elec. Serv.,* 809 F.2d at 630. At least some "significant probative evidence tending to support the complaint" must be produced. *Id.* Legal memoranda and oral argument are not evidence and do not create issues of fact capable of defeating an otherwise valid motion for summary judgment. *See British Airways Bd. v. Boeing Co.,* 585 F.2d 946, 952 (9th Cir. 1978).

The standard for a grant of summary judgment reflects the standard governing the grant of a directed verdict. *See Eisenberg v. Ins. Co. of North America,* 815 F.2d 1285, 1289 (9th Cir. 1987) (citing *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 250, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986)). Thus, the question is whether "reasonable minds could differ as to the import of the evidence." *Anderson,* 477 U.S. at 250-51.

The Ninth Circuit has established that "[n]o longer can it be argued that any disagreement about a material issue of fact precludes the use of summary judgment." *California Architectural Bldg. Products, Inc. v. Franciscan Ceramics, Inc.,* 818 F.2d 1466, 1468 (9th Cir. 1987). Moreover, the United States Supreme Court has stated that

"[w]hen the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1986).

Indeed, "if the factual context makes the nonmoving party's claim *implausible,* that party must come forward with more persuasive evidence than would otherwise be necessary to show that there is a genuine issue for trial." *Franciscan Ceramics,* 818 F.2d at 1468 (emphasis in original) (citing *Matsushita,* 475 U.S. at 587). Of course, all evidence and inferences to be drawn therefrom must be construed in the light most favorable to the nonmoving party. *See T.W. Elec. Serv.,* 809 F.2d at 630-31.

DISCUSSION

I. Ripeness

Initially, the Court must determine whether Plaintiff's takings claim is ripe. As the Ninth Circuit noted in *Richardson,* there are two hurdles to a regulatory taking claim brought in federal court:

> The first hurdle, . . . that the plaintiff obtain a final decision regarding the application of the regulation to the property at issue from the entity charged with implementing the regulation . . . does not apply to facial regulatory takings claims. . . . The first hurdle thus does not apply to [Plaintiff's] argument.
>
> The second hurdle stems from the Fifth Amendment's proviso that only takings without 'just compensation' infringe that Amendment; 'if a State provides adequate procedure for seeking

> just compensation, the property owner cannot claim a violation of the Just Compensation clause until it has used the procedure and been denied just compensation.'

Richardson, 124 F.3d at 1165. Because Chevron's argument that Act 257 does not substantially advance a legitimate state interest does not depend upon the extent to which Chevron is compensated, its facial regulatory taking claim is ripe.

II. The Takings Clause

The Takings Clause of the Fifth Amendment of the United States Constitution states: "[N]or shall private property be taken for public use, without just compensation." U.S. Const., Amend. V. The United States Supreme Court has consistently distinguished "physical takings" from "regulatory takings." A physical taking occurs when a governmental entity authorizes a permanent physical occupation of real property. *See Yee v. City of Escondido,* 503 U.S. 519, 535, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). By contrast, the regulatory taking issue typically arises when a government regulation, such as a zoning regulation or a rent control law, affects a property owner's ability to use his land. *See id.* In the words of Justice Holmes, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922).

The Court notes that it is well established that legislative acts come to the Court with a presumption of constitutionality, *see Concrete Pipe & Products of California, Inc. v. Construction Laborers Pension Trust,* 508 U.S.

602, 637, 124 L. Ed. 2d 539, 113 S. Ct. 2264 (1993); *Duke Power Co. v. Carolina Environmental Study Group, Inc.,* 438 U.S. 59, 83-84, 57 L. Ed. 2d 595, 98 S. Ct. 2620 (1978); *Usery v. Turner Elkhorn Mining Co.,* 428 U.S. 1, 15, 49 L. Ed. 2d 752, 96 S. Ct. 2882 (1976), and therefore Plaintiff faces an uphill battle in its challenge to Act 257.

A. Facial Challenge

When a party alleges that an act of the legislature effects an unconstitutional taking, they may bring either a "facial" challenge or an "as applied" challenge. The Supreme Court has repeatedly held that a land use regulation will be found to effect a taking if it does not substantially advance a legitimate state interest or denies the landowner economically viable use of his land. *See Dolan v. City of Tigard,* 512 U.S. 374, 385, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994); *see also, Lucas v. South Carolina Coastal Council,* 505 U.S. 1003, 1016, 120 L. Ed. 2d 798, 112 S. Ct. 2886 (1992); *Keystone Bituminous Coal Assn. v. DeBenedictis,* 480 U.S. 470, 485, 94 L. Ed. 2d 472, 107 S. Ct. 1232 (1987); *Agins v. Tiburon,* 447 U.S. 255, 260, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980).

The relevant inquiry in a facial challenge is whether "mere enactment" of the challenged regulation effects a taking. *See Agins,* 447 U.S. at 260. For example, in *Agins,* the city of Tiburon adopted zoning ordinances that limited development of appellant's five-acre lot to a maximum of five single-family residences. Appellants brought suit against the city, alleging that the ordinances prohibited all development of their land and thus effected a taking of their property. The California Supreme Court rejected appellants' request for a declaration that the zoning

ordinances were facially unconstitutional, holding that the terms of the challenged ordinances allowed the appellants to construct between one and five residences on their property. *See id.* at 262.

The Supreme Court granted certiorari, and held that the ordinances substantially advanced legitimate governmental goals. *See id.* at 261. In reaching this decision, the Court considered the benefits of the ordinances as well as any diminution in market value that the appellants might suffer. The Court also considered appellants' allegations that they wished to develop the land for residential purposes, that the land was the most expensive suburban property in the State, and that the best possible use of the land was residential, and held that although the ordinances limited development, they neither prevented the best use of appellants' land or extinguished a fundamental attribute of ownership. The Court further held that the general plan advanced a legitimate state interest – protection from urbanization. Finally, the Court noted that the ordinance did not impose a burden solely on one landowner, it affected development generally, and therefore the public did not benefit at the expense of a few. *See id.*

Similarly, in *Richardson,* the plaintiff brought a facial challenge to a rent control ordinance that placed a cap on renegotiated ground rent that could be charged by the owner of the land under condominium units. *See* 124 F.3d at 1163. The Ninth Circuit first considered the typical condominium ground lease scheme, noting that since the land underneath condominiums is ordinarily owned by someone other than the condominium owner-occupant, the condominium owner must lease the ground underneath the unit for long periods. The court went on to find that although these leases are initially fixed for a term of years,

the rent is subject to renegotiation which typically is based on a percentage of the fair market value of the land appurtenant to the unit, exclusive of improvements, as of the date of the renegotiation. Finally, the court recognized that the ordinance at issue was enacted because the rapid rise in Hawaiian land prices often resulted in renegotiated rents several hundred times greater than the initial fixed rent. Nonetheless, the Ninth Circuit declared the ordinance facially invalid, holding that the absence of a mechanism to prevent owner-occupants from capturing a premium upon the resale of their unit meant that the ordinance would not substantially further its goal of creating affordable housing. *See id.* at 1166.

In the instant case, Plaintiff brings a facial challenge to Act 257, arguing that the rent cap provision of the Act effects an unconstitutional taking because it fails to substantially advance a legitimate state interest and it leaves Plaintiff with no economically viable use of its land.

B. Applicable Standard in Regulatory Takings Analysis

Defendants argue that Act 257 does not effect a taking, and is therefore constitutional. Moreover, Defendants claim that Plaintiff is applying the wrong standard in evaluating the state interest portion of the takings analysis.

According to Defendants, in order for the Act to pass constitutional muster, it is not necessary that the Act *actually* further the state interest involved, but merely that the Legislature rationally could have believed that the Act would do so. In support of this argument, Defendants cite *Hawaii Housing Authority v. Midkiff,* 467 U.S.

229, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984). However, *Midkiff* dealt with a physical taking, rather than a regulatory taking, and is thus distinguishable from the present case. *See id.* at 233. In the physical taking context, the government exercises its eminent domain power to take private property for "public use." Furthermore, once the government decides to physically take property, it must provide just compensation to the person from whom the property was taken. At issue in *Midkiff* was the propriety of the purported "public use" advanced by the government to justify the taking. *See id.* at 235. The *Midkiff* Court held that the only requirement in a physical taking, since the taking is fully compensated, is that the legislature "rationally could have believed" the taking would serve the purported "public use." *See id.* at 242.

By contrast, the present case deals not with a physical taking, but with whether there has been a *regulatory* taking, an inquiry which requires a different analysis. In the regulatory taking context, the inquiry is not whether property has been taken for a public use, but rather, whether or not a government regulation substantially advances a legitimate state interest. As clarified in *Hall v. City of Santa Barbara,* 833 F.2d 1270 (9th Cir. 1986), *cert. denied,* 485 U.S. 940, 99 L. Ed. 2d 281, 108 S. Ct. 1120 (1988):

> In [*Midkiff*], the Court explored the meaning of the public use requirement in the Fifth Amendment's eminent domain clause. . . . The Court in *Midkiff* did not address the somewhat different articulation of the standard applicable in cases where there was no deliberate exercise of the eminent domain power. For example, it did not mention *Agins v. City of Tiburon* where it had noted that "the application of a general zoning

> law to a particular property effects a taking if the ordinance does not substantially advance legitimate state interests. . . . " The *Midkiff* Court left open the possibility that less deference would be afforded where government does not intend to effect a taking than where it does. . . . It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.

833 F.2d at 1280. The United States Supreme Court echoed this viewpoint in *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 835, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987), when it stated:

> We have required that the regulation [in the takings context] "substantially advance" the "legitimate state interest" sought to be achieved, not that "the state could rationally have decided" that the measure adopted might achieve the State's objective.

Id. Finally, the Ninth Circuit's opinion in *Richardson,* a case discussed by both parties in the instant case, further clarified this concept:

> The language used throughout *Midkiff* indicates that deference to the legislative body's public use determination is required when the taking is fully compensated. . . . [W]e believe that Nollan-Lucas-Dolan trio does not signal a change from this longstanding rule of deference because we see nothing inconsistent in applying heightened scrutiny when the taking is uncompensated, and a more deferential standard when the taking is fully compensated.

124 F.3d at 1158. Thus, the Court finds that, in order to determine whether the Act effects a taking, the appropriate inquiry is whether the Act substantially advances a legitimate state interest, not merely whether the legislature rationally believed it would do so.

C. Advancement of a Legitimate State Interest

The United States Supreme Court has not elaborated on the standards for determining what constitutes a "legitimate state interest" or what type of connection between a regulation and the state interest satisfies the requirement that the former "substantially advance" the latter. *Nollan*, 483 U.S. at 834. However, the Court has made clear that a broad range of governmental purposes and regulations satisfies these requirements. *See id.*

1. State Interests to be Advanced

Before determining whether a legitimate state interest is advanced by the Act, it is necessary to ascertain the specific state interests involved. Plaintiff argues that the purpose of Act 257 is to provide protection for service station lessee dealers. Defendants, however, assert that Act 257 is designed to protect consumers from the harmful effects of the highly concentrated petroleum market in Hawaii.

Defendants' contention is not without merit, for on its face, Act 257 appears to be directed toward the protection of consumers. Section 1 of Act 257 reads, in pertinent part:

> (1) The petroleum industry is an essential element of Hawaii's economy and is therefore of

> vital importance to the health and welfare of all people in the State of Hawaii; . . .
>
> (4) Because Hawaii is a physically small and geographically remote economy, certain of its markets tend to be concentrated. Market concentration is a function of the number of firms in the market and their respective market shares. In a highly concentrated market, market prices tend to rise above competitive levels. *Market prices persistently above competitive levels are harmful to consumers and the public.* Barriers to competition tend to cause supracompetitive prices to persist; and
>
> (5) The markets for oil and oil products in Hawaii are highly concentrated markets.

Haw. Rev. Stat. § 257 (1997) (emphasis added).

However, a closer examination of Act 257, specifically its legislative history, reveals another interest, namely "to provide certain protection for dealer operated retail service stations." Conf. Comm. Rep. 38, H.B. No. 1451 (1997).

While these two interests appear to be distinct from one another, they do not conflict. A thorough analysis of Defendants' argument reveals that in order to further the state's interest of protecting consumers, it is first necessary to help lessee dealers, whose viability might lead to a less concentrated – and thus more consumer friendly – market. Thus, the Court finds that while the legislature was mindful of the need to protect lessee dealers, this consideration was essentially a step toward the ultimate

goal of reducing gasoline prices for Hawaii's consumers.[3] Having ascertained the state interests to be advanced by Act 257, the Court's next task is to determine whether or not these interests are substantially advanced.

2. Advancement of State Interests

In support of its motion for partial summary judgment, Plaintiff argues that the Act fails to substantially advance a legitimate state interest. The Court agrees with Plaintiff, on two principal grounds.

a. New Dealers are Not Protected Because Incumbent Dealers Can Capture the Value of the Reduced Rent in the Form of a Premium

Defendants argue that the savings realized from reduced rent under the Act will lead to the continued business viability of independent dealers, keeping them in the market. They further argue that this, in turn, will lead to a less concentrated market, giving consumers more choices and lowering retail prices by way of increased competition.

Plaintiff argues, and the Court agrees, that the rent cap provision of the Act fails to protect new lessee dealers

[3] Even if the ultimate goal of the legislature was to help lessee dealers, Act 257 would still fail to substantially advance its purpose. As discussed below, incumbent lessee dealers can capture the value of the reduced rent in the form of a premium, thereby depriving incoming lessee dealers of the benefit of the rent cap. Similarly, oil companies can offset any decrease in rent with an increase in wholesale prices, and thereby eliminate the benefit to the lessee dealer.

because it allows incumbent dealers to capture the value of the decreased rent in the form of a premium. The existence of the rent cap makes an independent dealer's leasehold interest in a service station more valuable, and this added value becomes especially significant when an incumbent dealer undertakes to sell his interest. *See* Stipulation of Facts, ¶¶ 34, 35 at 10-11. Since the Act does not prohibit an incumbent dealer from selling his or her service station lease, the rent cap provision enables these dealers to sell their stations at a premium. *See id.* at ¶¶ 28, 29. Because the dealer to whom the interest is transferred will be required to pay the premium, the overall expense incurred by the incoming lessee dealer remains the same, and as a result, there are no savings to pass along to consumers.

In support of this argument, the Court finds *Richardson,* 124 F.3d at 1150, controlling. In *Richardson,* the Ninth Circuit addressed a rent control ordinance that placed a cap on renegotiated ground rent that could be charged by the owner of the land under condominium units. The ordinance was enacted for the purpose of providing affordable housing to owner-occupants. *Id.* at 1165. The trustees of the Bishop Estate, owner of the fee simple title to the land underneath condominiums that were affected by the ordinance, brought an action contesting the constitutionality of the ordinance. Since the owner-occupant of a condominium was free to transfer his or her "rent-controlled" leasehold interest, the owner-occupant was able to capture the value of that rent cap in the form of a premium. *Id.* at 1164. The ordinance was challenged by the plaintiff as an unconstitutional taking.

The Ninth Circuit affirmed the district court's finding that the ordinance effected a regulatory taking. According

to the Ninth Circuit, since the ordinance did not provide a mechanism to prevent the lessees from capturing the premium, the state interest in providing affordable housing was not substantially advanced, as ultimately the price of housing would remain the same. *Id.* at 1166.

Like *Richardson,* the possibility of a sales premium in the case at bar prevents the state interests from being substantially advanced. Act 257 fails to provide a mechanism to prevent dealers from capturing a premium. Indeed, cases like *Yee* and *Hall*[1] suggest that it is inappropriate, if not unconstitutional, to fail to provide a mechanism in rent control legislation to preclude the capture of a premium. *See Yee,* 503 U.S. at 527-31; *Hall,* 833 F.2d at 1279-80. Moreover, the potential for a premium in the present case is even more compelling than that in *Richardson,* since it is likely that a lessee dealer will find it easier to part with his or her business, than would a homeowner with his or her home. Presumably, a homeowner wishes to remain where he or she lives, whereas a businessperson is likely to view maximization of profits as the ultimate business goal. Thus, because an independent dealer can unilaterally negate any benefit a transferee might receive from the Act, it fails to substantially advance the state's interest in protecting new dealers.

Defendants argue that *Richardson* is distinguishable from the present case because the purpose of Ordinance 91-96, which was at issue in *Richardson,* and the purpose of Act 257 are distinct. The primary goal of Ordinance 91-96 was to provide affordable housing for owner-occupants of condominiums subject to ground leases. The "Findings and Purpose" section of Ordinance 91-96 states, in relevant part:

> The council finds that:
>
> * * *
>
> (3) . . . owner-occupants of condominium[s] . . . were not informed . . . of lease rent renegotiation . . . terms . . . of the lease, [which are] established unilaterally by the lessors. . . . ;
>
> (5) . . . Unless controlled, the renegotiated lease rents may be unaffordable to many owner-occupants of leased condominium housing units . . . ;
>
> (6) . . . owner-occupants may have no recourse but to terminate their leases or sell . . . and seek housing elsewhere . . . ;
>
> (7)(E) Residential leaseholds have also undesirable social effects . . . [because] as the lessee advances in age, [the] lessee's income potential declines, . . . causing the lessee to give up the lease . . . ;
>
> * * *
>
> The council further finds and declares:
>
> * * *
>
> (3) . . . lease rent increases of 1,000 percent would make home ownership unaffordable to a substantial number of owner-occupants of residential condominiums. . . .

Honolulu City and County, Haw. Ordinance 91-96 § 1. Defendants argue that unlike the ordinance at issue in *Richardson,* which was enacted to provide affordable housing, the purpose of Act 257 is not to provide affordable gas station purchases, but rather, to benefit consumers. Thus, even if transferee dealers are negatively impacted

by a premium, according to Defendants, incumbent dealers will still benefit from the rent cap and will thus pass along their savings to consumers, who will thereby benefit as well. The Court disagrees.

First of all, in *Richardson,* although the owner-occupants who retained their condominiums would clearly receive a direct benefit from the rent cap each month, the Ninth Circuit nonetheless declared the Ordinance unconstitutional because it failed to prevent owners of condominiums from capturing a premium upon the sale of their units, thereby depriving the purchasers of any benefit from the rent cap and resulting in the price of housing ultimately remaining the same. Moreover, while it is possible that some lessee dealers may benefit from the Act's rent cap in the form of lower overall costs, there is no reason to conclude that such dealers will react to this savings by lowering their retail prices. Dealers may instead elect to maintain a higher profit margin, since the Act includes no mechanism to prevent lessee dealers from simply keeping their prices the same and retaining the profit from the reduced rent on a month-to-month basis. Nothing has been presented to the contrary.[4]

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[4] The parties agree that under current conditions, Act 257's rent cap will only affect 11 of Chevron's 64 lessee dealer stations in Hawaii. *See* Stipulation of Facts, ¶ 6 at 4. Thus, less than 20 percent of Chevron's stations will be impacted by the rent cap. No evidence has been presented as to how the Act affects the remaining non-Chevron stations.

The Court nonetheless finds that Act 257 fails to substantially advance a legitimate state interest, because it is probable that consumers will not benefit from the rent cap as applied to these remaining stations. First, it is possible that, like 53 of Chevron's lessee dealer stations, the Act will not impact these other stations at all. If this is the case, then the Act will certainly not benefit consumers, since prices at

(Continued on following page)

b. Incumbent Dealers Are Not Protected Because Rent Reductions Can Be Offset By Wholesale Price Increases

Defendants also argue that since the rent cap provision of the Act helps incumbent dealers to maintain their viability, the market will be less concentrated, giving the consumer more choices. They go on to argue that this lowered concentration means more competition and thus lower retail prices. The Court finds it unlikely that the Act will lead to such a result.

There is no dispute that Plaintiff receives income from dealers in the form of both rent and fuel sales. Importantly, the Act does not place any limitation on the price of fuel sales. Thus, an oil company can raise fuel prices to

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these stations will remain unchanged. Second, even if the Act were to impact these stations, there is no mechanism to prevent incumbent dealers from capturing a premium upon the sale of their stations, as discussed at length above. Therefore, under either scenario, Act 257 does not substantially advance the state's interest in benefitting consumers.

Furthermore, even in the absence of a captured premium, the Act still fails to advance its purpose. As discussed infra, and as acknowledged by the government, Chevron can merely offset the decreased rent by increasing their gasoline prices, thereby negating any benefit to be achieved by the Act. The Court finds no reason why other oil companies would not act likewise. In light of these considerations, it is highly unlikely that the minimal number of dealers who might be benefitted by the Act would make a competitive impact if they were to lower their prices.

Finally, the fact that Act 257 allows Chevron to charge approximately $1.1 million more than it would otherwise have charged under its own rental program further demonstrates the Act's ineffectiveness in its purpose of protecting consumers. *See* Stipulation of Facts, Table 1.

compensate for the reduction in rent, and as a result, dealers will not receive any benefit from the rent cap.[5]

Defendants argue that although oil companies are free to raise fuel prices to offset any reduction in rent, they will not do so.[6] Defendants' expert states that an increase in wholesale fuel prices by an oil company would lead the

[5] In fact, Defendants have acknowledged this possibility in their brief. Defendants' brief reads, in relevant part:

> In contrast, Chevron's lessee dealer gas stations provide Chevron with two sources of revenue. Chevron uses both to pay the expenses it incurs in leasing the service stations. The first source is the contract rent that is subject to Act 257. The second source of revenue is from the sale of Chevron gasoline to lessee dealers which lessees are required to purchase from Chevron under the supply agreement Chevron requires of the dealer lessees. The revenue which Chevron receives from its gasoline sales is substantially greater than the contract rent. Act 257 does not impose a cap on the amount Chevron may charge for gasoline and other products it sells its lessee dealers. Therefore, Act 257 does not deprive Chevron of the ability to increase the DTW price, Chevron's primary revenue stream from its lessee stations, in the event of an increase in costs.

See Def.'s Mot. for Summ. J., p. 28-29 (citations omitted).

[6] Plaintiff's expert disagrees. It is evident from Plaintiff's expert's declaration that this can and will occur in response to a reduction in rent. *See* Declaration of John R. Umbeck, p. 3, ¶ 5(b); p. 8, ¶ 16; p. 11, ¶ 21. According to Plaintiff's expert, Act 257 will (1) penalize Chevron and its lessee dealers, reducing their viability in Hawaii; (2) penalize consumers because it can be expected to lead to higher retail gasoline prices; (3) not benefit future lessee dealers because dealers can capture the value of the rent cap in the form of a premium; and (4) not permit Chevron to earn a reasonable return on its investments. *See id.* at p. 3, ¶ 5. By contrast, Defendants' expert claims that Act 257 will (1) benefit consumers by decreasing the concentration in the gasoline market; (2) benefit both incumbent and transferee dealers; and (3) provide Chevron a reasonable return on its investment. *See* Declaration of Keith B. Leffler, p. 4-5, ¶ 7.

dealer to increase his retail fuel prices. This increased retail price, according to Defendants, would result in a decreased volume of fuel sales, which would ultimately hurt the oil company. However, Defendants' expert fails to explain why the oil company would not increase the wholesale price to simply offset the decrease in rent.[7] Indeed, there is no economic reason why a shift from paying a certain sum as "rent" to paying that same sum as "fuel price" would lead a dealer to react by raising his gas prices when his overall costs remain the same. By doing so, he would be acting against his own interest, running the risk of decreased sales because of the increased prices. Instead, it is likely that if a dealer's overall costs remain the same, he will choose to remain competitive by keeping his retail prices the same. Because oil companies can simply raise their wholesale prices to the same extent that rent decreases, the dealer is likely to be unaffected by the rent cap, and gas prices will remain unchanged.[8] Consequently, the Act's purpose of protecting the dealer – and thereby protecting the consumer – would not be met.

Since Chevron's Dealer Supply Contract allows a lessee dealer to purchase fuel from suppliers other than

[7] Neither Defendants nor Defendants' expert have offered any reason why this is not a feasible, and even likely, result.

[8] Although Defendants might argue that an oil company may not be able to accurately assess the amount of increase in wholesale price needed to offset the decrease in rental income, the parties agree that, where an economic benefit or loss is difficult to quantify, on average, the participants will estimate accurately. *See Declaration of Keith B. Leffler,* p. 11-12, ¶ 16 (discussing accuracy of estimating value of rent cap in order to calculate premium); *Declaration of John R. Umbeck,* p. 12, ¶ 22; p. 13, ¶ 24 (discussing estimation of rent cap value).

Chevron, one might argue that if Chevron were to offset the decreased rent as described above, a dealer would simply "go elsewhere" to purchase his fuel. However, the Court finds that this is neither a feasible nor practical alternative. First, the terms of the Dealer Supply Contract state that a lessee dealer must purchase from Chevron all fuel that is necessary to fulfill customer demand for Chevron gasoline. Thus, even if a dealer wishes to discontinue Chevron gasoline and sell another brand, he may not do so if a demand for Chevron gasoline exists. Second, according to the Dealer Lease, if a lessee dealer chooses to market and sell other gasoline, he must install his own pumps and tanks, and he must make it clear to consumers that the fuel contained therein is not Chevron fuel. As stipulated to by the parties, there are only two local refinery sources: Chevron, which supplies sixty percent of the gasoline produced or refined in Hawaii, and Tesoro, which supplies forty percent. *See* Stipulation of Facts, ¶ 38 at 11. Therefore, if a dealer chose to obtain gasoline from another source, it would be cost-prohibitive without some sort of "concerted action," since importing gasoline requires purchasing a large quantity and chartering a vessel to transport it. Because this is not a realistic alternative, the Court finds that a lessee dealer's mere ability to purchase fuel from other sources does not negate the probability that an oil company such as Chevron and Tesoro could be successful in defeating the rent cap by offsetting decreased rent with increased fuel prices.

For all of the reasons outlined above, the Court finds that Section 3(c) of Act 257 fails to substantially advance a

legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments of the Constitution.[9],[10]

III. Other Claims

Plaintiff moved for partial summary judgment only on its Second Claim for Relief, while Defendants moved for summary judgment on all claims. Defendants failed to satisfy their burden on Plaintiff's First, Third, Fourth, Fifth, Sixth, and Seventh Claims for Relief, because they did not present any evidence which demonstrates that there is no genuine issue of material fact as to those claims. This is particularly true with regard to Plaintiff's First Claim for Relief (Deprivation of Constitutional Rights in Violation of 42 U.S.C. § 1983) and Fifth Claim for Relief (impermissible taking in violation of the Hawaii Constitution), inasmuch as the Court finds that Act 257 effects an unconstitutional taking. Accordingly, summary judgment on those claims is DENIED.

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[9] While the Court recognizes that Plaintiff brings a facial challenge to Act 257, the Court notes that Act 257 has been in operation since June of 1997, and yet the state claims in its lawsuit filed on October 1, 1998, which alleges antitrust violations, that the price of gasoline for consumers is an average of $.30 per gallon higher than prices on the mainland This further illustrates the ineffectiveness of Act 257 in its purpose of benefitting consumers. However the Court has not considered the foregoing in reaching its decision.

[10] Plaintiff also challenges the Act as effecting an unconstitutional taking on two alternate grounds: (1) that it leaves them with no economically viable use of their land, and (2) that the Act fails to provide for individualized consideration. Because the Court finds that the Act fails to substantially advance a legitimate state interest, it need not address these alternate arguments.

In their brief, Defendants represented that Plaintiff "announced" that it would not pursue its due process and equal protection claims. However, the Court does not find anything in the record which indicates that Plaintiff abandoned these claims. If it can be established that Plaintiff did make such a withdrawal, Defendants are entitled to summary judgment on the Third, Fourth, Sixth, and Seventh Claims for Relief.

CONCLUSION

The Court finds that Act 257 fails to substantially advance a legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments of the United States Constitution. For the foregoing reasons, the Court hereby GRANTS Plaintiff's motion for summary judgment on its Second Claim for Relief.

IT IS SO ORDERED.

DATED: Honolulu, Hawaii, NOV 10 1998

Alan C. Kay

Chief United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHEVRON USA, INC., a Pennsylvania Corporation Plaintiff-Appellee, v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI*, Attorney General of the State of Hawaii, Defendants-Appellants.	No. 99-15108 D.C. No. CV-97-00933-ACK AMENDED ORDER (Filed Oct. 31, 2000)

Before: D.W. NELSON, BEEZER, and W. FLETCHER, Circuit Judges.

The majority of the panel has voted to deny the petition for rehearing. Judge W. Fletcher voted to grant the petition for rehearing. Judges D. Nelson and Beezer recommended denying the petition for rehearing en banc. Judge W. Fletcher votes to grant the petition for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge in active service has requested a vote to rehear the matter en banc. Fed. R. App. P. 35.

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* Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).

The petitions for rehearing and rehearing en banc are DENIED.

Hawaii revised statutes, Chapter. § 486H-10.4 Restrictions on manufacturers or jobbers in operating service stations; lease rent controls; definitions.

(a) Beginning August 1, 1997, no manufacturer or jobber shall convert an existing dealer operated retail service station to a company operated retail service station; provided that nothing in this section shall limit a manufacturer or jobber from:

(1) Continuing to operate any company operated retail service stations legally in existence on July 31, 1997;

(2) Constructing and operating any new retail service stations as company operated retail service stations constructed after August 1, 1997, subject to subsection (b); or

(3) Operating a former dealer operated retail service station for up to twenty-four months until a replacement dealer can be found if the former dealer vacates the service station, cancels the franchise, or is properly terminated or not renewed.

(b) No new company operated retail service station shall be located within one-eighth mile of a dealer operated retail service station in an urban area, and within one-quarter mile in other areas. For purposes of this subsection, "urban" means the first congressional district of the State, and "other areas" means the second congressional district of the State.

(c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:

(1) Such renewal shall not be scheduled more frequently than once every three years; and

(2) Upon renewal, the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen per cent of the gross profit of product, excluding all related taxes by the dealer operated retail service station as defined in section 486H-1 and [this section] plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purposes of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail service station after all applicable taxes, excluding income taxes, are paid. The provisions of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.

(d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.

(e) For the purposes of this section:

"Company operated retail service station" means a retail service station owned and operated by a manufacturer or jobber and where retail prices are set by that manufacturer or jobber.

"Dealer operated retail service station" means a retail service station owned by a manufacturer or jobber and operated by a qualified gasoline dealer under a franchise.

"Operate" means to engage in the business of selling motor vehicle fuel at a retail service station through any

employee, commissioned agent, subsidiary company, or person managing a retail service station under a contract and on a fee arrangement with the manufacturer or jobber.

"Retail" means a sale of gasoline made to the general public at prices that are displayed on the dispensing equipment.

CONFERENCE COMMITTEE
REPORT NO. 38

Honolulu, Hawaii
April 24, 1997
RE: H.B. No. 1451
H.D. 1
S.D. 1
C.D. 1

Honorable Joseph M. Souki
Speaker, House of Representatives
Nineteenth State Legislature
Regular Session of 1997
State of Hawaii

Honorable Norman Mizuguchi
President of the Senate
Nineteenth State Legislature
Regular Session of 1997
State of Hawaii

Sir:

Your Committee on Conference on the disagreeing vote of the House of Representatives to the amendments proposed by the Senate in H.B. No. 1451, H.D. 1, S.D. 1, entitled:

"A BILL FOR AN ACT RELATING TO THE PETROLEUM INDUSTRY,"

having met, and after full and free discussion, has agreed to recommend and does recommend to the respective Houses and final passage of this bill in an amended form.

The purpose of this bill as received is to:

(1) Repeal chapters 486E and 486I, Hawaii Revised Statutes (HRS), to consolidate petroleum industry reporting under the department of business, economic development, and tourism;

(2) Amend chapter 486H, HRS, to add a new section to provide certain restrictions on company operated retail service stations and provide certain protection for dealer operated retail service stations.

Your Committee has amended this measure to:

(1) Add legislative findings and declarations;

(2) Rename -5, "summary reports", to "analysis of information; audits and inspections; summary reports", and to include the expanded language of the original bill;

(3) Add a new section, -11, powers of the public utilities commission;

(4) Add a new part II, petroleum advisory council, establishment, and duties;

(5) Delete proposed language in 486H –, related to acquiring in any manner existing company operated or dealer operated retail service stations;

(6) Delete the proposed ratio language concerning company operated to dealer operated;

(7) Change distance between new company operated stations and dealer operated stations from two miles to one-eighth mile in an urban area, and one-quarter mile in other areas, and define the terms "urban" and "other areas";

(8) Amend the proposed lease renewal language to further clarify the lease rent caps provided that these provisions shall not apply to any existing contracts that may be in conflict with the provisions.

(9) Add language that nothing in the section shall prohibit a dealer from selling a retail service station;

(10) Repeal section 486H-10, Hawaii Revised Statutes;

(11) Delete the instructions to the revisor of statutes; and

(12) Make technical, nonsubstantive amendments for the purpose of clarification and to follow standard drafting format.

Your Committee on Conference is in accord with the intent and purpose of H.B. No. 1451, H.D. 1, S.D. 1, as amended herein, and recommends that it pass Final Reading in the form attached hereto as H.B. No. 1451, H.D. 1, S.D. 1, C.D. 1.

Respectfully submitted,

MANAGERS ON THE PART OF THE SENATE	MANAGERS ON THE PART OF THE HOUSE
/s/ Rosalyn H. Baker ROSALYN H. BAKER, Co-Chair	/s/ Terry Nui Yoshinaga, TERRY NUI YOSHINAGA, Co-Chair
/s/ David Y. Ige DAVID Y. IGE, Co-Chair	/s/ Ron Menor RON MENOR, Co-Chair
/s/ Malama Solomon MALAMA SOLOMON, Member	/s/ Terrance W.H. Tom TERRANCE W.H. TOM, Co-Chair
	/s/ Brian Yamane BRIAN YAMANE, Member

(2)

Supreme Court, U.S.
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No. 04-163

IN THE

Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON U.S.A. INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether this Court should grant review to decide if the substantial advancement test for a Fifth Amendment taking, as articulated in *Agins v. City of Tiburon*, 447 U.S. 255 (1980), and subsequent cases, remains a viable taking theory, when there is no split on this issue among the lower courts and this Court has reaffirmed the test in numerous cases.

2. Whether this Court should grant review to decide the level of scrutiny used in carrying out a substantial advancement analysis in the absence of a split among the lower courts, and where this Court has endorsed the standard applied in the decision below.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of this Court's rules, respondent Chevron U.S.A. Inc. ("Chevron") states that it is an indirectly wholly-owned subsidiary of ChevronTexaco Corporation, which is a publicly traded company, through the following intermediate entities: Chevron U.S.A. Holdings Inc., Texaco Inc., Chevron Asiatic Limited, Chevron Texaco Overseas Petroleum Inc., Texaco Exploration and Production Inc., and TEPI Holdings Inc.

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RESPONDENT'S BRIEF IN OPPOSITION

Since at least 1922, it has been firmly entrenched in this Court's Taking Clause jurisprudence that a taking claim can succeed even in the absence of actual governmental appropriation of property "if regulation goes too far." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922). At least since *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), and *Agins v. City of Tiburon*, 447 U.S. 255 (1980), this Court has recognized that such a regulatory taking occurs when land-use restrictions fail substantially to advance any legitimate state interest. In *Agins*, the Court addressed a facial challenge to zoning ordinances that restricted the property owners' ability to develop their parcel. *See id.* at 257-59. The Court unanimously held that a taking occurs if challenged legislation "does not substantially advance legitimate state interests." *Id.* at 260. Applying that requirement to the zoning ordinances at issue, the Court found that "the zoning ordinances substantially advance legitimate governmental goals" because they served to "protect the residents of Tiburon from the ill effects of urbanization," *id.* at 261, and "assur[ed] careful and orderly development of residential property with provision for open-space areas," *id.* at 262. Since *Agins*, the Court has repeatedly invoked this substantial advancement test in a variety of different taking contexts, and has applied it to invalidate land-use restrictions in two cases, *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), and *Dolan v. City of Tigard*, 512 U.S. 374 (1994).

Because of the stringent showing necessary to establish a taking under the substantial advancement test, it has been satisfied only very rarely. Only where legislation is so arbitrary that it achieves no substantial advancement of any valid interest may it be invoked by a property owner. Unsurprisingly, this strand of the Court's Taking Clause

jurisprudence has not occasioned as much litigation as the other taking tests. Nonetheless, this Court has reiterated on numerous occasions that the substantial advancement test remains a valid taking theory. *See infra* at 13-14. Similarly, the continued availability of this narrow taking theory has not occasioned any divisions among the lower courts.

This case was one of the rare cases in the lower courts where a piece of legislation did not substantially advance the State's interest and the district court struck the statute under the substantial advancement test. At issue was state legislation purportedly directed at protecting consumers from high retail gasoline prices, but that sought to do so by imposing fundamentally irrational restraints upon certain *lease* arrangements between oil companies and gasoline station operators that demonstrably could not have any bearing on that goal. The district court found a taking under the rationale of *Agins*, and the Ninth Circuit upheld that ruling, based on a factual record showing that the Hawaii law at issue abrogated Chevron's property rights without substantially advancing the State's asserted interest. This fact-specific ruling was squarely within this Court's precedents, and was consistent with the other lower courts that have applied the substantial advancement test. The petition should be denied.

STATEMENT OF THE CASE

Chevron is one of several companies that sell gasoline at wholesale in Hawaii. Chevron and its competitors have three options for selling gasoline to the public at retail. They can sell it themselves at stations they own and operate. They can sell it to individuals who own and operate their own stations ("open" or "two-party" dealers). Or they can sell it to individuals who lease and operate stations owned by the oil companies ("lessee" or "three-party" dealers). The rent control statute at issue here affects only the last category,

lease arrangements between oil companies and station operators.

Chevron sells most of its gasoline through lessee-dealer stations. Chevron enters into two standard agreements with each of its lessee-dealers. Under a lease agreement, the dealer agrees to pay Chevron a monthly rent. Under a supply contract, the dealer agrees to purchase fuel from Chevron to be sold at the station.

While the standard lease agreements run for three-year terms, dealers may transfer their occupancy rights during the course of the term, subject to Chevron's consent and the payment of a fee. The agreements do not restrict the price a dealer can collect for such a transfer. The parties have stipulated that "[a]ssuming everything else remains equal, the market value of the lessee-dealer leasehold reasonably could be expected to increase as the amount of rent payable decreases." ER 64, ¶ 35.[1]

A. Hawaii's Act 257

On June 21, 1997, Hawaii enacted Act 257. The stated purpose of the statute was to combat the effects of concentration in the market for gasoline in Hawaii, which the Legislature believed was causing higher gasoline prices to consumers. The Act sought to accomplish this by, among other things, capping the rent Chevron and other oil companies could collect from lessee-dealers at 15% of the dealer's profit on gasoline sales and 15% of the dealer's gross sales on products other than gasoline (plus an increase to adjust for increases in the oil company's ground lease, where applicable).

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[1] "ER" refers to the Excerpts of Record below. "SER" refers to the Supplemental Excerpts of Record below.

The statute was unaccompanied by any legislative findings that the rents charged to dealers were the cause of concentration in the Hawaii market, that rents caused high prices to consumers, or that capping rents would result in lower prices. The State introduced no evidence below that the Legislature had conducted any hearings or compiled any evidence on these issues.

The statute prevented Chevron from collecting rent for which it would otherwise be entitled to bargain. At each of Chevron's 64 lessee-dealer stations, the law required Chevron to collect less in motor fuel facilities rent than it otherwise would have collected under its current rental program. The parties stipulated that the statute freezes the rents at a level *below* that necessary for Chevron to recoup its expenses associated with its lessee-dealer stations in Hawaii.

B. The Litigation And Evidence Below

Chevron brought this suit to enjoin enforcement of Act 257 as an invalid taking without just compensation in violation of the Fifth Amendment. Chevron argued that the Hawaii law did not "substantially advance legitimate state interests," as required by *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980).

The district court granted summary judgment for Chevron. Pet. App. 94-118. It held that the rent cap provisions would not advance the State's purposes because they provided no mechanism to prevent incumbent dealers from capturing the benefit of the reduced rent simply by transferring their leases at prices that incorporate the increased value of the franchise, with the result that the new dealers would have no savings to pass on to consumers. Pet. App. 108-12 (citing *Yee v. City of Escondido*, 503 U.S. 519, 527-31 (1992)). The district court also observed that oil companies could offset any rent reduction merely by raising wholesale gasoline charges. Pet. App. 113-17.

On appeal, the Ninth Circuit held that the district court had applied the correct legal standard in requiring that the statute substantially advance a legitimate state interest, and that the district court had properly focused on whether the rent control statute would in fact achieve its goals. Pet. App. 58-66. It held that the substantial advancement test in this context requires only that a "reasonable relationship" exist between the legislation and the goals it was designed to advance. Pet. App. 76. But it held that the district court had "'short-circuited the fact-finding process'" under that standard by resolving the issue without a trial. Pet. App. 72. The State unsuccessfully petitioned for rehearing, and then sought review by this Court in a petition raising substantially the same issues as those raised in the present petition. This Court denied *certiorari*. *Cayetano v. Chevron U.S.A. Inc.*, 532 U.S. 942 (No. 00-1198, Mar. 26, 2001).

On remand, following additional discovery, the case was tried before the district court. The evidence established the following:

(1) *There was no direct benefit to consumers*. Both sides agreed that the rent reductions mandated by Act 257 would not directly lower prices for consumers. As the State acknowledged to the district court, "[b]oth [parties'] economists agree that as a matter of economic principle, this will not happen. If the dealer has money in his pocket [from a rent reduction], it is not expected that he will hand it over to the consumer in the form of lower prices." SER 41; *see also* SER 46-49.

(2) *High gasoline prices are not caused by lessee-dealer rents*. The State's expert admitted that any high gasoline prices in Hawaii are not caused by the rents charged to lessee-dealers. Indeed, it was stipulated that the monthly rent Chevron charges its lessee-dealers does not cover Chevron's expenses associated with its lessee-dealer stations, and has not for at least twenty years. ER 60, ¶ 23. The

State's expert identified several factors contributing to high gasoline prices in Hawaii — none of which were addressed by Act 257 — including concentration at the wholesale level, relatively high State gasoline taxes, and high entry barriers at the wholesale level. SER 11-18.

(3) *Retail prices would go up if the oil companies responded to Act 257 by raising their wholesale gasoline prices.* Both sides' experts testified that the price consumers pay for gasoline would increase if the oil companies raised their wholesale prices in response to the rent cap. SER 6, 31, 47, 49. While the parties differed over whether such a response was likely, the State's expert conceded that oil companies factor into their wholesale gasoline prices the company's expenses associated with the station. SER 7, 32-33. If companies cannot recover station expenses in rent payments from dealers, they will therefore increase gasoline prices. The State did not cross-examine Chevron's expert, or offer any rebuttal evidence, on this point.

(4) *To the extent that wholesale (and thus retail) prices did not rise, the statute would result in decreased investment in lessee-dealer stations, contrary to the purpose of the statute.* Both sides also agreed that if the oil companies did *not* recoup their lost rental revenue by increasing wholesale prices, the result would have been a reduced incentive to invest in lessee-dealer stations (as opposed to the other means of conveying their gasoline to consumers discussed above). SER 36-39.

(5) *Act 257 would allow incumbent dealers to capture a premium rather than lowering dealer costs.* While the State initially argued that the law would help lessee-dealers to stay in business by lowering their costs, ER 142, ¶ 23, the evidence established that any rent reduction would create a premium in the value of the service station leasehold that would be reflected in the leasehold's sale price. The

incumbent dealers could capture this premium by selling the franchises at prices reflecting their increased value.

(6) *Decreases in dealers' costs would be irrelevant to consumer welfare, because the key decision whether to invest in dealer stations is the oil company's, not the dealer's.* It was undisputed that the decision whether to keep a station in business ultimately belongs to the oil company that owns it, not the lessee-dealer. SER 20, 36. To the extent that Act 257 resulted in reduced rental income to the company, it would hasten rather than delay the point at which continued operation became uneconomic for the oil company. ER 110-11, ¶ 26.

Given the foregoing evidence, the district court ruled that Act 257 failed substantially to advance a legitimate state interest, and entered judgment for Chevron. Pet. App. 30-53. It found that, rather than decreasing the price of gasoline in Hawaii, the "direct effect of Act 257 will actually be to cause retail gasoline prices to *increase*." Pet. App. 44, ¶ 31 (emphasis added).[2] The district court also found that, absent such offsetting price increases, oil companies would "avoid investing in new and existing lessee-dealer stations," leading to "fewer lessee-dealer stations than there would be without Act 257." Pet. App. 49, ¶ 49.

The Ninth Circuit affirmed. Pet. App. 24. It reiterated its holding from the previous appeal that the substantial advancement test is a valid taking theory under this Court's and its own cases, finding the State's argument to the contrary to be barred by the law of the case. Pet. App. 6-13. It also reiterated that the intermediate "reasonable relationship" standard was the proper requirement for

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[2] In light of this finding, which was undisturbed on appeal, petitioners' distinction between price reduction and avoidance of future price increases, Pet. 2 n.1, is immaterial.

satisfying the substantial advancement test in this context. Pet. App. 13-17. While more exacting than "the more deferential[] rational basis test" urged by the State, this "intermediate level of review" is "less stringent than the 'rough proportionality' test used in the context of exactions under the Takings Clause." Pet. App. 13-14. The court determined that the facts found by the district court were not clearly erroneous, and supported the judgment for Chevron under the foregoing legal standards. Pet. App. 17-24.

Judge Fletcher dissented. He did not dispute the continuing validity of the substantial advancement test; to the contrary, he acknowledged that it is a "test ordinarily applied to zoning and other land use regulations." Pet. App. 25. Moreover, he agreed with the majority that "[t]he evidence put on by the State's expert in support of Act 257 was sufficiently weak, and the countervailing evidence put on by Chevron's expert was sufficiently strong, that the district court did not err in concluding that th[e substantial advancement] test was not satisfied." Pet. App. 26. Nonetheless, adopting a position that petitioners do not advance here, Judge Fletcher opined that the substantial advancement test does not extend to rent control legislation unless it is shown that the legislation will necessarily allow the incumbent lessee to collect a premium upon transfer of the leasehold interest, a showing Judge Fletcher believed had not been made. Pet. App. 26-29.

REASONS FOR DENYING THE PETITION

I. THE CONTINUING APPLICABILITY OF THE SUBSTANTIAL ADVANCEMENT TAKING TEST IS NOT AN ISSUE WARRANTING REVIEW.

Petitioners claim that there is uncertainty in this Court's decisions and among the lower courts over whether the substantial advancement test can be applied to establish a taking claim. No such uncertainty exists. The substantial advancement test is firmly entrenched in this Court's cases

involving a variety of different taking contexts. And there is no split in the lower courts over whether the test is applicable in cases such as this.

A. Petitioners Mischaracterize The Decisions Of Other Lower Courts In An Unsuccessful Effort To Manufacture A Conflict With The Decision Below.

Petitioners try to demonstrate a split in the lower courts by first asserting that the decision below "directly conflicts" with *Brunelle v. Town of South Kingstown*, 700 A.2d 1075 (R.I. 1997), and *Mission Springs Inc. v. City of Spokane*, 954 P.2d 250 (Wash. 1998), which petitioners describe as having held that "challenges to the rationality of government regulation must be brought under the Due Process Clause." *See* Pet. 16. Neither case, however, made any such pronouncement and neither addressed the issue decided by the opinion below.

Brunelle involved a claim by a property owner that local officials had arbitrarily refused to correct an error in zoning his property, which had prevented him from proceeding with a planned building project. The court concluded that no taking occurred because the error had no substantial economic impact or interference with investment-backed expectations given that the project would not have been permitted even absent the error. 700 A.2d at 1081-83. The owner also argued that officials' decision was arbitrary and capricious. In addressing that separate claim, the court stated in a footnote that "the arbitrariness or capriciousness of a particular state action" should be examined under the Due Process Clause rather than the Takings Clause. *Id.* at 1083 n.5. This footnote does not conflict with the decision below. Whether a claim of arbitrariness by local officials in refusing to correct a zoning error arises under the Taking Clause (and, if so, the standard that governs that claim) is a different question from that addressed in this case involving a legislative enactment restricting rent. The Rhode Island

Supreme Court's view of taking analysis in the former context says nothing about its application to the latter. Significantly, the year after it issued *Brunelle*, the Rhode Island Supreme Court recognized the substantial advancement standard as a valid taking test in the land-use context. *See Woodland Manor III Assocs. v. Keeney*, 713 A.2d 806, 811 (R.I. 1998) (citing *Agins* for the proposition that "a taking occurs in situations in which a regulation does not substantially advance legitimate state interests" (internal quotation marks omitted)).

Mission Springs is even further afield, as it did not even mention, let alone question, the substantial advancement test. The plaintiff in *Mission Springs* challenged local officials' allegedly wrongful failure to process a grading permit. *See* 954 P.2d at 252. The permit ultimately issued, so the only challenge was to the procedures leading to that approval. *See id.* at 253-54. Plainly, no substantial advancement challenge would have been available in this context, and none was made or considered by the court. The Court held that due process principles governed the analysis because the allegations involved "arbitrary interference with *that process* lawfully due." *Id.* at 258 (emphasis added).

Similarly groundless is petitioners' claim that the decision below conflicts with *Tampa-Hillsborough County Expressway Authority v. A.G.W.S. Corp.*, 640 So.2d 54 (Fla. 1994), and *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334 (N.J. 2001). Pet. 16-17. The issue in those cases was whether a determination that a particular land use restriction was invalid meant that a per se taking had occurred entitling the landowner to compensation. The courts ruled that no per se taking had occurred — rulings that anticipated this Court's decision in *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 333-34 (2002). But no question was presented or discussed in either case whether a regulatory taking could be found under the substantial advancement

test. Contrary to petitioners' implicit assumption, a finding of invalidity under state law or under due process principles does not equate to finding that the restriction fails the substantial advancement test, because not all laws that are stricken as arbitrary will fail to further any legitimate purpose (*e.g.*, because they may be unfairly retroactive or contain irrational exemptions that nonetheless do not defeat their overall effectiveness). Indeed, the Florida Supreme Court in *Tampa-Hillsborough* expressly reserved the issue of the applicability of the Taking Clause in that case. *See* 640 So.2d at 58 ("[W]e wish to make clear that our discussion does not bar any person who owned land within maps of reservation from making a [taking] claim against the government."). Thus, there is no inconsistency in holding that such a ruling of invalidity does not necessarily result in taking.

Petitioners' assertion that the decision below conflicts with decisions of other federal circuits, Pet. 17, is likewise erroneous. Far from rejecting the substantial advancement test, *Simi Investment Co. v. Harris County, Texas*, 256 F.3d 323 (5th Cir. 2001) (per curiam), *see* Pet. 17, cites *Agins*, *Nollan*, and *Dolan* as examples of a "takings analysis established by the Supreme Court and this circuit [that] should control constitutional violations involving property rights that have been infringed by governmental action." *Id.* at 323-24 & n.4. Petitioners rely on the court's statement that claims of "illegitimate and arbitrary governmental abuse" could be brought under the Due Process Clause. *Id.* at 323. But the court did not state that such claims would be to the exclusion of a substantial advancement claim under the Takings Clause.

A footnote in *Restigouche, Inc. v. Town of Jupiter*, 59 F.3d 1208 (11th Cir. 1995), *see* Pet. 17, states, with no analysis or case citations, that what it called "'fails to substantially advance' takings" are not "distinct" taking claims "in the zoning context" "[a]dditional[]" to "just

compensation takings." *Id.* at 1211 n.1. Whatever the court meant by this cryptic comment, it does not create any circuit conflict. The comment was dicta, as the court did not reach the merits of the taking claim, but rather dismissed it as unripe. *See id.* at 1212. And, in accord with the Ninth Circuit's ruling below, the Eleventh Circuit has subsequently expressly reiterated that the substantial advancement test remains fully applicable, including in the zoning context. *See, e.g., Corn v. City of Lauderdale Lakes*, 95 F.3d 1066, 1072 (11th Cir. 1996) (holding in the zoning context that, if a challenged law "does not substantially advance legitimate state interests," a taking claim is established (citing *Agins*)).

Rather than conflicting with the decision below, *Rith Energy, Inc. v. United States*, 270 F.3d 1347 (Fed. Cir. 2001), *see* Pet. 17, affirmatively cited *Agins* for the rule that a "land use regulation does not effect a taking if it substantially advances legitimate state interests," *id.* at 1352 (internal quotation marks and brackets omitted), and found substantial advancement of a legitimate purpose because the revocation of a mining permit "was an exercise of the police power directed at protecting the safety, health, and welfare of the communities surrounding the Rith mine site by preventing harmful runoff," *id.* Similarly, *Florida Rock Industries, Inc. v. United States*, 791 F.2d 893 (Fed. Cir. 1986), *see* Pet. 17, cited and applied *Agins*, concluding that a mining restriction satisfied the substantial advancement test because "the preservation of wetlands bears a substantial relationship to the public welfare as perceived by the best lights of our time." *Id.* at 904.

Finally, *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993 (Cal. 1999), *see* Pet. 19, also recognizes the validity of, and applies, the substantial advancement test to a rent control law. *See* 968 P.2d at 1000-04. There, the California Supreme Court concluded that the requirement was satisfied because the plaintiff had "not allege[d] that the Santa Monica Rent Control Law fail[ed] to advance the purpose of

preventing excessive and unreasonable rent increases caused by the shortage of and increased demand for housing in the City or that existing tenants ha[d] not obtained protection from excessive or unreasonable rent increases." *Id.* at 1003 (internal quotation marks and ellipsis omitted).

B. This Court Has Not Cast Doubt On The Continuing Applicability Of The Substantial Advancement Test.

Petitioners' claim that various Justices of this Court have expressed uncertainty over the validity of the substantial advancement test is also wrong. Pet. 9. In a wide variety of cases spanning more than a quarter of a century, this Court has consistently recognized the "substantial advancement" test as a valid means of establishing a taking claim. While the showing it requires has rendered it inapplicable except in rare cases, many cases have reaffirmed its availability. The first express articulation of the test occurred in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), where the Court found it "implicit" in earlier cases that an interference with property rights "may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose." *Id.* at 127. Two years later, in *Agins*, the Court expressly held that legislation interfering with property rights must "substantially advance legitimate state interests" to withstand a Taking Clause challenge, and the Court applied that requirement in upholding challenged zoning ordinances. 447 U.S. at 260.

This Court has since repeatedly reiterated the availability of the substantial advancement test in a long and unbroken line of cases. *See Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 333-34 (2002) (noting that property owner could have made the argument that non-exaction land-use restrictions "did not substantially advance a legitimate state interest" to support a taking claim); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 704 (1999) (noting that jury

instruction requiring "that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions" was "consistent with our previous general discussions of regulatory takings liability"); *Dolan v. City of Tigard*, 512 U.S. 374, 385 (1994) ("A land use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests'" (quoting *Agins*, 447 U.S. at 260)); *Lucas v. S. Carolina Coastal Council*, 505 U.S. 1003, 1016 (1992) (noting that the Court had recognized the validity of the substantial advancement test "on numerous occasions"); *Yee v. City of Escondido*, 503 U.S. 519, 530 (1992) (noting that there must be "a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance"); *Nollan v. Calif. Coastal Comm'n*, 483 U.S. 825, 834 (1987) ("We have long recognized that land-use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests'" (quoting *Agins*, 447 U.S. at 260)); *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985) (noting that the substantial advancement test represents part of "our general approach" in takings cases).

These cases recognize the applicability of the test in taking cases generally, and not just in cases involving "exactions" (*i.e.*, required transfers of interests in real property to secure development approvals). *See, e.g.*, *Tahoe-Sierra Preservation Council, Inc.*, 535 U.S. at 233-34 (noting that theory could have been advanced in non-exaction case); *City of Monterey*, 526 U.S. 704 (noting consistency of substantial advancement theory with the Court's precedents "outside the context of required dedications or exactions" even though the precise application had not been delineated); *Yee*, 503 U.S. at 530 (noting applicability of test outside exactions context); *Nollan*, 483 U.S. at 841 ("We are inclined to be *particularly* careful about the adjective ['substantial'] where the actual conveyance of property is made a condition to the lifting of a land-use restriction" (emphasis added)). Indeed, *Agins* itself involved a challenge

to zoning ordinances rather than an exaction, so petitioners' suggestion that the substantial advancement test has not been applied outside the context of exactions is incorrect. Pet. 9-10, 12. Moreover, while petitioners equivocate regarding whether they accept the substantial advancement test as valid even in the exaction context, their merits arguments against the substantial advancement doctrine would apply with equal force to the exaction context.

In the face of all of these cases, petitioners rely primarily on *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998). That case offers petitioners no support. *Eastern Enterprises* involved a challenge to provisions of the Coal Health Benefits Act that imposed retroactive liability for retired coal miners' health benefits upon coal operators with attenuated relationships with those miners. *See id.* at 514-15. The focus of the Taking Clause dispute involved whether monetary obligations between private entities of the sort imposed by the statute in that case constitute takings. *Compare id.* at 522-24 (concluding that "economic regulation such as the Coal Act may nonetheless effect a taking") *with id.* at 541-47 (concluding that the Taking Clause did not apply because the statute imposed only an economic burden and did not burden a "specific property right or interest") (Kennedy, J., concurring in the judgment and dissenting in part). The plaintiffs made no claim that the statute failed substantially to advance a valid purpose, and no such claim could have been advanced in that case, because the law plainly advanced the public purpose of funding the benefits to retired miners. Indeed, the plurality (which included the only justices to find a taking) did not even cite *Agins* or allude to the substantial advancement test. Rather, it applied the alternative three-prong test for a regulatory taking. *See id.* at 529.

Unsurprisingly in light of the fact that there was no substantial advancement claim at issue in *Eastern Enterprises*, Justice Kennedy's concurring opinion did not

question that the theory was a valid means of establishing a taking claim. To the contrary, Justice Kennedy expressly *presupposed* its validity. Justice Kennedy cited the substantial advancement test in the course of discussing why, in his view, courts should require a high degree of specificity in identifying "a specific property interest to implicate the Takings Clause." *Id.* at 544. Justice Kennedy noted the perceived "uneasy tension with our basic understanding of the Takings Clause," *id.* at 545, not to *question the applicability* of the substantial advancement theory — for that would have undercut his statement that special care is required in identifying property rights with specificity — but rather to *presuppose* it as a ground for justifying caution in defining the range of cognizable taking claims. *See id.* at 544-45. In short, Justice Kennedy's concurrence in *Eastern Enterprises*, a case that did not involve the substantial advancement theory, offers no support to petitioners. Any doubt on this score is removed by the post-*Eastern* decisions in which the Court has reaffirmed the applicability of the test. *See Tahoe-Sierra Preservation Council, Inc.*, 535 U.S. at 334; *City of Monterey*, 526 U.S. at 704. Indeed, Justice Kennedy, in writing for the Court in *City of Monterey*, acknowledged that the trial court's instruction on the substantial advancement test was consistent with this Court's takings precedents. 562 U.S. at 704.

The opinion of the dissenters in *Eastern Enterprises* is similarly unavailing to petitioners. The dissenters did not mention the substantial advancement test or cite *Agins*, let alone call that test into question. And each of the dissenting Justices in *Eastern Enterprises* subsequently joined the opinion of the Court in *Tahoe-Sierra*, which cited the test as an avenue the plaintiff there could have invoked to challenge the land-use restrictions. 535 U.S. at 334.

Apart from *Eastern Enterprises*, petitioners' only other ground for claiming that there is "[u]ncertainty" about the continued applicability of the substantial advancement test,

Pet. 9, is that the opinions of Justice Scalia and Justice Souter in *City of Monterey* expressed no opinion on the applicability of the substantial advancement test in that case because it had been waived. *See* 526 U.S. at 732 n.2 (Scalia, J., concurring in part and concurring in the judgment) ("As the Court explains, petitioner forfeited any objection to this standard and I express no view as to its propriety." (citation omitted)); *id.* at 753 n.12 (Souter, J., concurring in part and dissenting in part) (offering "no opinion" on the substantial advancement issue). Of course, the failure to express an opinion because an issue is not properly before the Court is not to cast doubt upon a question on the merits. Petitioners mischaracterize these opinions in claiming that they "acknowledg[e] that it is at least an open question." Pet. 9. Indeed, petitioners ignore that Justice Scalia in *City of Monterey* joined the majority's conclusion that the substantial advancement instruction in that case was "consistent with our previous general discussions of regulatory takings liability," *id.* at 704; *see id.* at 723 (Scalia, J., concurring in part and concurring in the judgment) ("I join all except Part IV-A-2 of Justice KENNEDY's opinion.").

C. Petitioners Offer No Valid Reason To Reconsider The Substantial Advancement Test For The First Time Now, In The Absence Of Any Split In The Lower Courts.

Petitioners' claims that the substantial advancement test would "effect a dramatic change in takings jurisprudence," Pet. 12, or herald a return to *Lochner*-era activism, Pet. 15, are unfounded. The foregoing shows that the substantial advancement taking test is deeply embedded in this Court's Taking Clause jurisprudence At the same time, the test is rarely applied because it invalidates governmental action only in extraordinary cases such as this where a law is so wholly ineffective or arbitrary as to substantially further no valid state objective. As this Court emphasized in *Nollan*, it

has "made clear" that "a broad range of governmental purposes and regulations satisfies these requirements." 483 U.S. at 834-35 (collecting cases). The very fact that the substantial advancement test has been available for decades without triggering any widespread invalidation of state legislation or lower court split underscores that there is no confusion or crisis in the federal courts warranting this Court's review.

Nor are petitioners correct that review of legislation under the Taking Clause should be no more searching than under the Due Process Clause. Pet. 15. The Due Process Clause is directed primarily toward ensuring the adequacy of *procedural* safeguards in protecting personal interests generally (including interests in "life" and "liberty," as well as "property"). *See, e.g., Collins v. City of Harker Heights, Texas*, 503 U.S. 115, 125 (1992) (noting that "[t]he most familiar office of th[e Due Process] Clause is to provide a guarantee of fair procedure in connection with any deprivation of life, liberty, or property by a State"). While the Court has recognized an application of that clause in prohibiting certain undue substantive intrusions, "[a]s a general matter, the Court has always been reluctant to expand the concept of substantive due process" to protect interests not specifically delineated in the Constitution. *Id. See also Moore v. City of E. Cleveland, Ohio*, 431 U.S. 494, 543-44 (1977) (White, J., dissenting) ("[W]e must always bear in mind that the substantive content of the Clause is suggested neither by its language nor by preconstitutional history; that content is nothing more than the accumulated product of judicial interpretation of the Fifth and Fourteenth Amendments.").

The Taking Clause, by contrast, is a specific provision directed solely toward protecting the right of "private property" against governmental appropriation. It supplies an independent ground to inquire into the effect of legislation in the context of intrusions on property rights, such as the right

at issue here, to collect real property rents. As the Court held in *Dolan*, the Taking Clause is "as much a part of the Bill of Rights as the First Amendment or Fourth Amendment," and it should not "be relegated to the status of a poor relation." 512 U.S. at 392.[3]

Petitioners' other merits argument — that the remedy in a taking case is compensation rather than invalidation of a statute and that therefore the substantial advancement test is at odds with the purposes of the Clause, Pet. 12 — is similarly incorrect. Where legislation attempts to convert private property without affording the compensation required under the Clause, this Court has recognized that enjoining the legislation is appropriate. As the *Eastern Enterprises* plurality noted without disagreement from any other Justices, "it would entail an utterly pointless set of activities" if the government were to appropriate money and then pay a claim for compensation, "for every dollar [taken] . . . would be presumed to generate a dollar of . . . compensation." 524 U.S. at 521 (internal quotation marks and brackets omitted). In these circumstances, "it cannot be said that monetary relief against the Government is an available remedy," and, accordingly, it is proper for the taking itself to be declared unconstitutional and enjoined. *See id.* In keeping with these principles, this Court has on several occasions enjoined legislation under the Taking Clause. *See, e.g., Babbitt v. Youpee*, 519 U.S. 234, 243-45 (1997) (affirming invalidation of provision of Indian Land Consolidation Act); *Hodel v. Irving*, 481 U.S. 704, 716-18 (1987) (same); *Webb's*

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[3] Thus, petitioners' reliance upon *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), is misplaced. Pet. 22-23. In *Exxon*, the Court addressed due process and other challenges to a State law. No claim under the Taking Clause was asserted or addressed, and there is no ground to suppose that any substantial advancement claim even could have been made against that entirely different legislative scheme.

Fabulous Pharmacies v. Beckwith, 449 U.S. 155, 160 (1980) (holding that taking "was obviously uncompensated" and violated Taking Clause). Indeed, this was the remedy in this Court's seminal regulatory taking decision, *Pennsylvania Coal v. Mahon*, 260 U.S. 393 (1922). As this Court has noted, in that case "the Court held that the statute was *invalid* as effecting a 'taking' without just compensation." *Penn Cent. Transp. Co.*, 438 U.S. at 127-28 (emphasis added).

Petitioners' reliance upon *First English Evangelical Lutheran Church v. County of Los Angeles, California*, 482 U.S. 304 (1987), to support a contrary conclusion is misplaced. Pet. 12. *First English* merely observed that the purpose of the Taking Clause is to require compensation rather than to impose substantive limits on lawmaking power. *See* 482 U.S. at 314. It did not address the separate issue of what remedy is appropriate where a statute on its face improperly burdens a property interest but does *not* provide the required compensation. Nothing in *First English* indicates that a damages remedy on an inverse condemnation claim is the sole remedy available to a plaintiff, and it did not so much as hint that it had overruled *Pennsylvania Coal* or the other cases authorizing injunctive relief. *See, e.g.*, *Shalala v. Illinois Council on Long Term Care, Inc.*, 529 U.S. 1, 18 (2000) ("This Court does not normally overturn, or so dramatically limit, earlier authority *sub silentio*."). While *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984), presumed that claims for compensation against the United States should be brought in the Court of Federal Claims before taking claims could be asserted in district court, *see id.* at 1016, this presumption does not apply in cases involving monetary takings, where compensation would defeat the entire purpose of the challenged legislation, rending a *post facto* compensation claim "an utterly pointless set of activities." *Eastern Enters.*, 524 U.S. at 521 (internal quotation marks omitted).

II. THE LEVEL OF SCRUTINY IN APPLYING THE SUBSTANTIAL ADVANCEMENT TEST IS NOT AN ISSUE WARRANTING REVIEW.

As noted above, the Ninth Circuit did not apply "[*d*]*e* [*n*]*ovo* [r]eview" of the legislative judgment, as petitioners claim. Pet. 23, 27. Rather, it noted that there were several possible levels of scrutiny, including a stricter "rough proportionality" test used in the land exaction cases, and the rationality standard used in some due process cases. Pet. App. 14. And it expressly adopted "an intermediate level of review, more stringent than the rational basis test used in the due process context but less stringent than the 'rough proportionality' test." Pet. App. 14. The Ninth Circuit referred to this intermediate level as a "'reasonable relationship' test." Pet. App. 13-14. While the decision below rejected "the more deferential[] rational basis test" suggested by petitioners, Pet. App. 13, it did not adopt a *de novo* approach, but rather expressly took a middle ground, affording the State's judgment more deference than it would receive in other substantial advancement contexts. Pet. App. 13-14.

Contrary to petitioners' assertions, no lower court split exists on these issues. An intermediate standard is precisely what other lower courts have adopted, and what this Court's cases require.

A. Petitioners Have Identified No Lower Court Split Regarding The Appropriate Level of Scrutiny In Applying The Substantial Advancement Test.

Petitioners cite four cases allegedly evidencing a split among the lower courts regarding the level of scrutiny to be applied in carrying out the substantial advancement analysis. None supports petitioners' argument.

South County Sand & Gravel Co. v. Town of South Kingstown, 160 F.3d 834 (1st Cir. 1998), did not "h[o]ld that

the 'substantial relation' and 'rational basis' standards may be used 'interchangeably' in reviewing a challenged zoning ordinance," as claimed by petitioners. Pet. 28. To the contrary, it expressly declined to decide that question, explaining, "[w]e need not probe the point today, for the outcome of this case would be the same under either standard." 160 F.3d at 836 n.3.

Far from disagreeing with the decision below, *Bonnie Briar Syndicate, Inc. v. Town of Mamaroneck*, 721 N.E.2d 971 (N.Y. 1999), Pet. 28-29, expressly adopted the precise intermediate standard used by the Ninth Circuit in this case. After rejecting the more exacting "essential nexus" standard used by *Nollan* as limited to the context of exactions, *id.* at 975-76, *Bonnie Briar Syndicate* ruled that "the applicable standard" outside the exactions context is whether the legislation "'bears a *reasonable relationship* to that objective.'" *Id.* at 976 (quoting *City of Monterey*, 536 U.S. at 701) (emphasis in *Bonnie Briar Syndicate*). This is the same standard, drawn from the same Supreme Court case, as that adopted by the Ninth Circuit here. Pet. App. 13-14.

Finally, the decisions of the Supreme Court of California in *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993 (Cal. 1999), and *San Remo Hotel L.P. v. City & County of San Francisco*, 41 P.3d 87 (Cal. 2002), are similarly consistent with the decision below. *Santa Monica Beach* rejected application of the heightened *Nollan* and *Dolan* exaction standard to the rent control ordinance challenged in that case, but expressly declined to decide what standard was applicable. *See* 968 P.2d at 1002. And *San Remo Hotel* rejected application of the *Nollan* and *Dolan* exaction standard to an ordinance governing hotel conversions, but expressly adopted the "reasonable relationship" standard used by the Ninth Circuit in this case. *See* 41 P.3d at 105-06 (holding that the legislation "must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development," and that

"[w]hile the relationship between means and ends need not be so close or so thoroughly established for legislatively imposed fees as for ad hoc fees . . ., the arbitrary and extortionate use of purported mitigation fees, even where legislatively mandated, will not pass constitutional muster").

In short, all of petitioners' cases either apply the identical standard to the decision below or expressly decline to decide the issue.

B. Petitioners' Proposed Rationality Standard For Reviewing Legislation Under The Substantial Advancement Test Is Inconsistent With This Court's Precedents And Would Abrogate The Test.

Petitioners' proposal that the substantial advancement test outside the exactions context should employ the due process rational basis standard is also incorrect on the merits. By its terms, this Court's requirement that legislation *substantially* advance a valid state interest requires a different inquiry from mere rationality review. This Court emphasized this distinction in *Nollan*, where it observed that "our verbal formulations in the takings field have generally been quite different" from those in the Due Process context. 483 U.S. at 834 n.3 (noting that substantial advancement test is facially different from due process rational basis standard).[4]

In keeping with this observation, this Court's cases have consistently indicated that the substantial advancement test requires more than mere due process rationality review, even outside the exaction context. As noted above, the Ninth

[4] Contrary to petitioners' characterization, Pet. 26-27, *Nollan* does not justify a rational basis standard outside the exaction context. Its statement that courts should be "*particularly* careful about the adjective" "substantial" in the exaction context necessarily means that the substantiality requirement applies outside that context as well. 483 U.S. at 841 (emphasis added).

Circuit drew its "reasonable relationship" standard from *City of Monterey*, where this Court commented favorably on that formulation without definitively resolving the issue. *See* 526 U.S. at 704 (noting that the reasonable relationship standard used in that case was "consistent with our previous general discussions of regulatory takings liability"). Similarly, *Yee* indicated that in the rent control context there must be "a sufficient nexus between the *effect* of the ordinance and the objectives it is supposed to advance." 503 U.S. at 530 (emphasis added). That inquiry is simply not encompassed in the due process rational basis test, which does not look to the actual effect of legislation.

Petitioners rely on *Keystone Bituminous Coal Association v. DeBenedictis*, 480 U.S. 470 (1987). Pet. 24-25, 27. Yet the language they quote from that case involves a separate issue: the requirement that takings, even where compensated, must involve a "public use." *See* 480 U.S. at 487 n.16. In his dissent, Chief Justice Rehnquist expressly emphasized this limitation: "[O]ur inquiry *into legislative purpose* is not intended as a license to judge the effectiveness of legislation." *Id.* at 511 n.3 (Rehnquist, C.J., dissenting). When courts inquire into the separate issue of whether a taking is for a public use, they look at purpose rather than effectiveness, and they use a more deferential standard in doing so. *Keystone* discussed and applied the *Agins* substantial advancement test in a separate portion of the opinion. *See id.* at 492-97. And the more deferential standard applied to the "public use" prong of the Taking Clause analysis is sensible, because unlike in the substantial advancement context, the state is there paying for the property it takes. *See, e.g., Richardson v. City & County of Honolulu*, 124 F.3d 1150, 1158 (9th Cir. 1997).

Moreover, applying the rational basis standard from the due process context in applying the substantial advancement test, as petitioners suggest, would be incoherent, because it would render the substantial advancement test wholly

superfluous. Any law that fails the due process rational basis standard would independently be unconstitutional under the Due Process Clause; therefore, one would never need to reach the *Agins* test. If the substantial advancement inquiry were not heightened beyond the minimal Due Process rationality requirements, the substantial advancement theory would be legally inert, contrary to the numerous cases of this Court establishing that test as a valid independent theory under the Taking Clause.

CONCLUSION

The petition for a writ of *certiorari* should be denied.

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Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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REPLY BRIEF FOR PETITIONERS

As the petition for *certiorari* showed, the Ninth Circuit has erroneously taken language in this Court's decision in *Agins v. Tiburon*, 447 U.S. 255, 260 (1980), as a broad warrant to engage in the second-guessing of the wisdom and efficacy of state economic regulation under the Just Compensation Clause. Other appellate courts have properly recognized that this Court intended no such revival of the *Lochner* era, and that the Just Compensation Clause does not authorize heightened scrutiny of the validity of economic regulation. Chevron predictably seeks to minimize the significance of the issues raised by the decision below and to deny the confusion in the lower courts surrounding these questions, but it cannot hide the critical importance of these issues or the need for this Court's review. The *amicus* briefs filed by 22 Attorneys General, the National Conference of State Legislatures, five associations of municipal governments, and the League of California Cities confirm the serious threat posed to democratic governance and to federalism by the Ninth Circuit's unprecedented and profoundly misguided decision.

Chevron does not dispute that this case is an appropriate vehicle for the Court to resolve the questions surrounding the ostensible "substantially advance" test, as it presents none of the obstacles that prevented the Court from doing so in prior cases. Moreover, while Chevron raises factual arguments concerning the efficacy of Act 257, it also does not dispute that the Act would easily survive the deferential review traditionally applied to social and economic legislation under the Due Process

Clause.[1] Both issues presented by this petition are thus outcome determinative in this case.

The urgent need to resolve these issues is confirmed by a very recent Ninth Circuit decision striking down yet another rent control ordinance under the "substantially advance" takings test, prompting Judge Fletcher to decry that court's "return to judicial activism": "We learned in

[1] Chevron does attempt to sow confusion about the efficacy of Act 257 by arguing, as it argued below, that the Act would not have the effect of immediately lowering retail gasoline prices in Hawaii. Opp. 5-7. But as the State explained in the *certiorari* petition, it has never been the State's position that the Act was enacted for that purpose. Rather, Act 257 was designed to protect consumers by *preserving* the structure of the retail market for gasoline in Hawaii, which is currently relatively unconcentrated in a manner beneficial to consumers. Although Chevron argues that Act 257 may have some unquantified adverse impact on retail gasoline prices, it does not dispute that the statute was intended to protect consumers from the risk of *future* price increases if independent retailers were squeezed out of business, Opp.7 n.2, nor does it dispute that the Act will prevent that outcome – as the trial court expressly found. App. 48. There is also no evidence, and the district court made no findings, that any incidental effects on *current* gasoline prices caused by the Act would outweigh the potentially severe harm to consumers that, in the judgment of the State legislature, would likely occur if the retail market for gasoline were concentrated in the hands of a few large oil companies.

In further efforts to confuse, Chevron misleadingly states that Act 257 limits its collection of "motor fuel facilities rent" at each of its stations, Opp. 4, implying that it has suffered economic loss at each station. In fact, "motor fuel facilities rent" is only one component of the overall rent allowed under Act 257. App. 37, 122. Chevron stipulated that it can receive more rent under Act 257 than it would have charged at virtually all of its stations (and can receive more rent in aggregate from its stations as a whole). ER 56-57, 66-68. Chevron also asserts that Act 257 "freezes" rents at a level below that necessary for Chevron to recoup its expenses, Opp. 4, but fails to disclose that it customarily sets its rents for leased stations below its expenses, relying on its profits from the sale of gasoline to the dealers. App. 38-39. Chevron stipulated that it will receive a return on its stations under Act 257 "that satisfies any Constitutional standards." ER 60. By itself, that stipulation should be conclusive of Chevron's taking challenge.

the 1930s that economic regulation is generally done better by politically accountable legislators than by life-tenured judges. I regret to say that the Ninth Circuit is unlearning that painfully learned lesson." *Cashman v. City of Cotati*, 374 F.3d 887, 905 (9th Cir. 2004) (W. Fletcher, J., dissenting). Absent direction from this Court, the Ninth Circuit will plainly continue its *de novo* review of the policy wisdom of social and economic legislation under the Just Compensation Clause.[2]

I. THE APPLICABILITY OF THE "SUBSTANTIALLY ADVANCE" TEST FOR ESTABLISHING A TAKING WARRANTS THIS COURT'S REVIEW

Chevron's contention that opinions of this Court reflect "no uncertainty" regarding the validity of the substantially advance test is breathtakingly inaccurate. Both *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), and *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), plainly recognize that the validity of the substantially advance test, as an ostensible general test for a taking,[3] is open to serious doubt. In

[2] Contrary to Chevron's statement that this is a fact-specific case, and its suggestion that the substantially advance test will be applied only "rarely," the Ninth Circuit's recent decision in *Cotati* bears out Judge Fletcher's warning that "virtually all rent control laws in the Ninth Circuit" may now be unconstitutional under this standard. App. 29.

[3] Contrary to Chevron's suggestion, Opp. 15, the State does not question the decisions in either *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987) or *Dolan v. City of Tigard*, 512 U.S. 374 (1994). Those decisions merely recognize that an exaction may constitute a taking if it is demanded as a condition for regulatory approval of development rather than imposed outright, and use means-ends scrutiny to ensure that planning authorities do not, in effect, indirectly impose takings through such conditions. No such concern is presented in this case, or in the vast majority of other cases involving regulatory takings challenges to economic regulations.

Eastern Enterprises, five Justices rejected the premise of this purported test, namely, that inquiry into the legitimacy of governmental action properly lies under the Just Compensation Clause. Although the lack of a specific property interest formed one basis for Justice Kennedy's conclusion that the Just Compensation Clause was inapplicable in *Eastern Enterprises,* Justice Kennedy *also* rested his conclusion on the fact that "the constitutionality of the [statute] appears to turn on the legitimacy of Congress' judgment rather than on the availability of compensation." 524 U.S. at 545. Justice Breyer's dissent agreed that the Just Compensation Clause is not concerned with "preventing arbitrary or unfair government action, but with providing *compensation* for legitimate government action that takes 'private property' to serve the 'public' good." *Id.* at 554.

In *Del Monte Dunes*, the Court explicitly said that it had never explained "the nature *or applicability*" of the "substantially advance" test outside the context of exactions. 526 U.S. at 704 (emphasis added). Chevron's contention that Justices Scalia and Souter's statements in *Del Monte Dunes* reserving the validity of the "substantially advance" test, *id.* at 732 n.2, 753 n.12, signified nothing at all borders on the ridiculous. Those Justices' statements plainly were meant to dispel any inference that the Court's affirmance of the lower court's judgment, having been based in part on the city's waiver of its objections to this test, should be read as endorsing this test.[4]

[4] Contrary to Chevron's assertion, the Court's subsequent reference to the substantially advance test in *dictum* in *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 333-34 (2002), cannot be read as resolving the uncertainty about this test. The Court merely identified that test as one of several "arguable" theories that might have been advanced, but quickly concluded that it was foreclosed by the facts. At most, *Tahoe-Sierra*

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To convert the "substantially advance" test into a warrant for broad judicial inquiry into the wisdom or effectiveness of governmental action would be inconsistent with this Court's long-settled understanding of the purpose of the Just Compensation Clause. As the Court emphasized in *First English Evangelical Lutheran Church v. County of Los Angeles,* 482 U.S. 304, 315 (1987), the Just Compensation Clause "is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." Chevron's assertion that the Clause can equally well be used to *enjoin* improper governmental action stands this "basic understanding" on its head.[5]

Chevron also fails in its attempt to obscure the conflicts that abound in the lower courts. The square rejection of a "substantially advance" takings claim in *Brunelle v. Town of South Kingstown,* 700 A.2d 1075, 1083 n.5 (R.I. 1997), for example, cannot be ignored on the basis that it involved a zoning issue; nothing in that decision suggests that the court would have reached a different conclusion for rent control.[6] Nor does Chevron deal convincingly with

indicates that the Court considers the validity of this ostensible takings test unresolved. Chevron's argument illustrates a larger point, however: this Court's repeated citation to the *Agins* test, combined with its evident doubts concerning its validity, creates confusion that only the Court can resolve.

[5] Chevron errs in suggesting that an injunction was appropriate in this case under a "monetary takings" exception to the general rule that the remedy for a taking is compensation. Opp. 20-21. If that exception exists, a question not definitively resolved by *Eastern Enterprises*, it has no application here. Act 257 does not require Chevron to pay out money, but rather regulates the price at which it leases its property.

[6] *Woodland Manor III Assocs. v. Keeney*, 713 A.2d 806, 811 (R.I. 1998), does not contradict *Brunelle*, since the court cited *Agins* in that case only for the proposition that a regulation that denies economically viable use of property constitutes a taking.

Tampa-Hillsborough County Expressway Auth. v. A.G.W.S. Corp., 640 So.2d 54 (Fla. 1994), and *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334 (N.J. 2001). Both cases involved claims that an invalid law can be held to effect a taking solely because it does not substantially advance a legitimate state interest. The Florida and New Jersey Supreme Courts both rejected that proposition, making clear that a regulatory taking claim must be based on a showing of economic injury. These decisions therefore conflict with the Ninth Circuit's decision.

Contrary to Chevron's reading of *Simi Investment Co. v. Harris County*, 256 F.3d 323 (5th Cir. 2001), that decision holds that claims of "illegitimate and arbitrary governmental abuse" should be brought under the Due Process Clause, rather than the Just Compensation Clause. This is confirmed by the court's recognition, in its initial opinion in that case, that the plaintiff's allegation that the county interfered with its property rights for no legitimate public purpose did not support a taking claim. 236 F.3d at 248 and n.12. Similarly, Chevron's bewilderment at the Eleventh Circuit's statement in *Restigouche, Inc. v. Town of Jupiter*, 59 F.3d 1208, 1211 n.1 (11th Cir. 1995), that that court does not "recognize [failure to substantially advance claims] as distinct, viable federal constitutional claims in the zoning context" does nothing to dispel that court's holding. The Eleventh Circuit has in fact evolved a distinctive typology for claims challenging land use regulations, *see Eide v. Sarasota County*, 908 F.2d 716, 720-22 (11th Cir. 1990), that does not include "substantially advance" claims.[7]

[7] *Corn v. City of Lauderdale Lakes*, 95 F.3d 1066 (11th Cir. 1996), cited by Chevron, actually underscores the confusion surrounding the "substantially advance" test. In that case, the Eleventh Circuit stated that the challenged law satisfied the purported "substantially advance" test for a taking under *Agins* – but rested that conclusion on a prior

(Continued on following page)

Finally, Chevron is unable to explain away the Federal Circuit's settled rule that a plaintiff cannot establish a taking by challenging the underlying legitimacy or wisdom of the government's action. *Rith Energy, Inc. v. United States*, 270 F.3d 1347, 1352 (Fed. Cir. 2001), cited *Agins* only in assessing the character of the governmental action under the three-part *Penn Central* test, and rejected the claim that government's action may be assailed as a taking because it is illegitimate. *Florida Rock Industries, Inc. v. United States*, 791 F.2d 893, 904 (Fed. Cir. 1986), similarly cited *Agins* only in passing and in another context, and squarely rejected any assertion of a takings claim based on the legitimacy or efficacy of government action, reversing the trial court for attempting to assess whether the government's regulation in fact protected water quality. *Id.* at 898-99. Both cases are thus squarely inconsistent with the decision in this case.

II. THE STANDARD OF REVIEW FOR ESTABLISHING A TAKING IS ALSO AN IMPORTANT ISSUE ON WHICH THERE IS CONFLICT IN THE LOWER COURTS

Chevron also misses the mark in disputing that the intrusive standard of review applied by the Ninth Circuit in this case raises an issue warranting this Court's review. Chevron seeks to obscure the extraordinarily intrusive standard of review applied by the Ninth Circuit, denying that it represents *de novo* review, and characterizing it instead as an "intermediate" level of review. Opp. 21. But

decision that had rejected a challenge to the law under *substantive due process*. *Id.* at 1072, *citing Corn v. City of Lauderdale Lakes*, 997 F.2d 1369 (11th Cir. 1993). At most, therefore, the Eleventh Circuit views the "substantially advance" test as indistinguishable from the traditionally deferential inquiry under the Due Process Clause.

the Ninth Circuit clearly conducted an independent assessment of the utility of Act 257: the court directed the trial court to conduct a judicial inquiry into the efficacy of Act 257, to be decided as a *factual matter by a preponderance of the evidence at trial* without any deference to legislative judgment.

Chevron's characterization of this standard as "intermediate" does not alter its *de novo* character, and cannot mask its intrusiveness. Whether or not the Ninth Circuit's standard is less stringent than the so-called "rough proportionality" test, under which the burden shifts to government to defend the constitutionality of exactions, it is a standard that has not been applied to social and economic *legislation* since the discredited era of *Lochner v. New York*, 198 U.S. 45 (1905).[8] The effect of this expansion in judicial review in the Ninth Circuit will be profound: the traditional "rational basis" test for social and economic legislation challenged under Due Process and Equal Protection will be completely supplanted by *de novo* takings challenges testing the effectiveness of legislation as a matter of "predictive fact."

Chevron provides no justification for such a radical departure from established constitutional principles. The *Agins* Court's use of the word "substantially" does not support heightened scrutiny; the "substantially advance" formulation was derived from Due Process cases that employed highly deferential review. Pet. 23-24. Chevron offers no explanation for why a test concededly drawn from Due Process should be applied using a standard entirely inconsistent with the standard under that provision. Nor do this Court's decisions lend any support to

[8] This Court concluded in *Dolan* that the heightened review established for exactions applies only to *adjudicative* decisions, not to legislation. 512 U.S. at 391 n.8.

such an intrusive standard of review. Although this Court has recognized the propriety of means-ends scrutiny in the special context of exactions (*see* note 2, *supra*), it has made clear that the standards articulated in those cases do not apply generally to takings claims. *Del Monte Dunes*, 526 U.S. at 703. On the other hand, this Court's decision in *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987), addressing a challenge to general legislation under the Just Compensation Clause, unanimously rejected inquiry into the effectiveness of the legislation, and strongly implied that deferential review is appropriate.[9]

Finally, Chevron fails to explain away lower court decisions that conflict with the Ninth Circuit's approach. In *South County Sand & Gravel Co. v. Town of South Kingstown*, 160 F.3d 834 (1st Cir. 1998), the court termed the difference between the "substantial relation" and "rational basis" standards "semantics," and stated that the substantive due process analysis it employed in a prior case "is fully consonant" with takings analysis. *Id.* at 836. Most importantly, the First Circuit squarely rejected review of the efficacy of a challenged regulation, finding such review "well outside our compass." *Id.* at

[9] Chevron errs in asserting that *Keystone* addressed the appropriate standard of review for the "public use" requirement of the Just Compensation Clause. *Keystone* was not a public use case, and the remarks of both the majority and the dissent cited in the State's petition were clearly directed at the appropriate standard for evaluating a substantially advance claim. Chevron mistakenly suggests that the Court in *Keystone* addressed the substantially advance claim "separately"; the portion of the opinion it cites addresses diminution in value and investment-backed expectations. *See* 480 U.S. at 492-97. Chevron also errs in inferring heightened review from the "reasonable relationship" instructions given to the jury in *Del Monte Dunes*; the Court did not rule definitively upon the merits of those instructions, and gave no guidance as to what that general language implies regarding the appropriate standard of review.

839. Similarly, the California Supreme Court in *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993 (Cal. 1999) plainly held that allegations that a law is ineffective in achieving its goals are out of bounds in a takings case, and gave broad deference to the legislature's judgment. *Id.* at 1000, 1003, 1006-07. These cases stand in direct conflict with the Ninth Circuit's instructions to the trial court to conduct a *de novo* inquiry into Act 257's effectiveness.

CONCLUSION

The petition for *certiorari* should be granted.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

(5)

No. 04-163

SEP 3 - 2004

In The Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF THE LEAGUE OF CALIFORNIA CITIES AS *AMICUS CURIAE* SUPPORTING PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

Amicus curiae the League of California Cities submits this brief in support of the petition for a writ of certiorari.[1] This case involves a challenge based upon the Takings Clause of the Fifth Amendment to the right of democratically elected legislatures to establish economic policy. Seeking to preserve competition in the retail gasoline market, the State Legislature of Hawaii limited the rent oil companies may charge dealer/lessees to use oil company-owned service stations. The Ninth Circuit Court of Appeals found that federal courts have the power to strike down such statutes as "takings" where the court determines, based on its own weighing of evidence presented in court, that the regulation will not be effective.

Each of the member cities of the League is within the jurisdiction of the Ninth Circuit, and is therefore subject to that court's decision. Because the Ninth Circuit's transfer of power to formulate economic policy from legislatures to courts could have pervasive implications for local regulatory authority under the police power, this Court should consider the cities' viewpoint in this brief.[2]

INTRODUCTION

At issue in this case is which branch of government determines economic policy: democratically elected legislatures or courts. *Agins v. City of Tiburon*, 447 U.S. 255 (1980) has led to this controversy. In that case, the Court

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[1] The League of California Cities is an association of all 478 California cities united in promoting the general welfare of cities and their citizens. The League is advised by its Legal Advocacy Committee, which is comprised of 24 city attorneys representing the 16 divisions of the League from all parts of the state. The Committee monitors appellate litigation affecting municipalities and identifies those cases that are of statewide significance.

[2] Counsel for the parties did not author this brief in whole or in part. No person or entity other than the *amicus* made a monetary contribution to the preparation or submission of this brief. Chevron has filed a blanket consent to the filing of *amicus* briefs.

held that courts are empowered to find that a regulation effects a "taking" of property under the Takings Clause of the Fifth Amendment if the regulation fails to "substantially advance legitimate state interests." *Id.* at 260.

Review of the Ninth Circuit opinion is warranted for two reasons. First, the substantially advance test allows courts to determine whether the regulatory means chosen by legislatures will be effective to achieve their ends. Until *Agins*, this Court had consistently held that the Due Process Clause provides the proper framework for judicial review of the wisdom and efficacy of government regulation. The Court limited regulatory takings to circumstances where regulation severely diminishes property value. The text of the Takings Clause, its original understanding, and takings jurisprudence provide no support for importing a means-ends test to the Takings Clause.

Second, assuming that a regulation can be deemed a "taking" merely because the regulation fails to advance a public purpose, lower courts disagree as to the level of judicial review the substantially advance standard requires. This case presents an opportunity for the Court to provide much needed guidance to the lower courts as to the scope of judicial review of economic regulation.

Since *Agins*, this Court and the lower federal and state courts have interpreted the substantially advance takings test to require either: (1) deferential judicial review – a test akin to rational basis; or (2) nondeferential review – known as "heightened scrutiny." The nondeferential standard of review arises from this Court's decisions in *Nollan v. Cal. Coastal Comm'n*, 483 U.S. 825 (1987) and *Dolan v. City of Tigard*, 512 U.S. 374 (1994). In those cases, the Court held that the judiciary may subject exactions of physical interests in land imposed on individual permit applications to heightened scrutiny. However, as this Court recognized in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702 (1999): "[W]e have not extended the rough proportionality test of *Dolan* beyond the special context of exactions – land-use

decisions conditioning approval of development on the dedication of property to public use. . . . "

Nevertheless, in *Chevron USA, Inc. v. Cayetano*, 224 F.3d 1030 (9th Cir. 2000), *cert. denied*, 532 U.S. 942 (2001) ("*Chevron I*"), *on remand*, 198 F.Supp.2d 1182 (D. Ha. 2002), *aff'd sub nom, Chevron USA, Inc. v. Bronster*, 363 F.3d 846 (9th Cir. 2004) ("*Chevron II*"), the Ninth Circuit went beyond administratively imposed, adjudicatory land exactions to apply nondeferential review to price control legislation. The Ninth Circuit opinions conflict with the interpretation given the substantially advance standard by other circuits and by the California courts. The Ninth Circuit opinions allow the courts to discard any notion of deference to the decisions of a legislative body as to the efficacy of economic regulation. Accordingly, the Ninth Circuit has vastly expanded judicial power to second-guess legislative policy decisions. Under *Chevron*, unelected and life-tenured judges would become super-legislatures, substituting their judgments as to wise and effective economic policy for those of elected and politically accountable representatives. This frontal assault on representative democracy runs contrary to basic principles of separation of powers and warrants review by this Court.

STATEMENT OF THE CASE

In 1997, Hawaii adopted Act 257 ("Act") to limit rents that oil companies may charge their retail gas station dealer/lessees for leasing company-owned stations to 15% of the dealer/lessee's gross profit from gasoline sales. App. 2.[3] The Act is designed to prevent oil companies from increasing rents to levels that would likely push independent dealers out of the already limited retail gasoline market.

Relying on *Agins*, *Nollan*, and *Yee v. City of Escondido*, 503 U.S. 519 (1992), Chevron challenged the Act as a regulatory taking on the ground, among others, that the

[3] Citations to the decisions of the lower courts are to the Appendix to the Petition for a Writ of Certiorari.

Act does not substantially advance legitimate state interests. App. 3, 63. Applying heightened scrutiny to the Act, the district court entered summary judgment for Chevron on its takings claim. App. 103-116.

In a two-to-one decision in *Chevron I*, the Ninth Circuit concluded that the district court correctly held that heightened scrutiny applied, allowing the court to inquire into the efficacy of the Act. App. 58-60. However, the majority found that whether the Act substantially advanced legitimate state interests raised triable issues of fact, and remanded the case to the district court for an evidentiary hearing as to whether the Act would actually accomplish its purpose. App. 79.[4]

On remand, the district court applied the substantially advance standard to determine whether the Act effected a taking. To predict the economic effects of the Act, the court heard testimony from economists representing each side of the issue. App. 40-46. The district court agreed with the theories advanced by Chevron's economist. The district court concluded that the Act effects a taking because it "does not substantially advance the State's legitimate interest in lowering gasoline prices." App. 53.

On appeal in *Chevron II*, the State argued that the substantially advance standard is not a legitimate test for a taking, and even if it were, that the district court, out of deference to the judgment of the Hawaii Legislature, should have applied a standard of review equivalent to the due process rational basis test. App. at 5. The same panel of the Ninth Circuit affirmed, again in a two-to-one decision. Relying on the law of the case, the majority rejected the State's arguments. App. 13-16. The court also addressed the State's arguments on the merits, finding that the court's application of heightened review in *Chevron I*

[4] As pointed out in the Petition for a Writ of Certiorari, the Ninth Circuit mistakenly assumed that the purpose of the Act was to *decrease* gasoline prices, rather than to maintain robust competition, prevent monopolization, and ultimately avoid price *increases*. See Petition at 2.

was not clearly erroneous. App. 14-16. In his dissenting opinion, Judge Fletcher objected to the court's application of heightened scrutiny: "Rent control is often inefficient and sometimes unfair. But we should not confuse inefficiency and unfairness with unconstitutionality." App. at 29.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

I. REVIEW BY THIS COURT IS NECESSARY TO ESTABLISH A CLEAR STANDARD OF JUDICIAL REVIEW FOR ECONOMIC REGULATION.

A. This Court's Decisions Have Created Confusion Regarding the Legitimacy and Scope of the Substantially Advance Test.

The legitimacy of the substantially advance test as a test for a regulatory taking is open to serious debate. The degree of judicial deference to legislative enactments has fluctuated over time. Between 1897 and 1936, the Supreme Court embraced a *laissez faire* economic philosophy. In its most extreme application of *laissez faire*, *Lochner v. New York*, 198 U.S. 45 (1905), the Court struck down a state law designed to safeguard the health of bakers by limiting their working hours. In *Lochner*, the Court freely exercised its own judgment as to the appropriate policy for the health of bakers. *See id.* at 56-57. But Justice Oliver Wendell Holmes' dissent in *Lochner* laid the foundation for the eventual repudiation of *Lochner's* free-market philosophy: "Some of these laws embody convictions or prejudices which judges are likely to share. Some may not. But a Constitution is not intended to embody a particular economic theory, whether of paternalism . . . or of *laissez faire*. . . . " *Id.* at 75.

Beginning in 1934 and continuing for more than 50 years, the Court abandoned the intrusive *Lochner*

standard.[5] In *United States v. Carolene Products Co.*, 304 U.S. 144 (1938), the Court thoroughly embraced the deferential standard of review of economic legislation:

> [T]he existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless . . . it is of such a character as to preclude the assumption that it rests on some rational basis. . . . *Id.* at 152.

Since the demise of *Lochnerian* substantive due process, this Court has generally reviewed economic regulation under the Due Process Clause by applying the deferential rational basis test.[6] Under that test, the court must uphold the regulation unless no reason can be conceived to support it. *Carolene Products*, 304 U.S. at 152. The burden is on the party challenging the regulation to prove that it constitutes an arbitrary regulation of property rights. *Id.* Indeed, in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), this Court upheld a Maryland statute strikingly similar to Act 257 against a due process challenge. The Maryland law sought to foster competition among retail gas suppliers by prohibiting oil companies from owning retail gas stations. The Court emphatically rejected the notion that the courts have a role in forging this type of economic policy:

[5] *See, e.g., Nebbia v. New York*, 291 U.S. 502, 537 (1934) ("[A] state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adopted to its purpose"); *Ferguson v. Skrupa*, 372 U.S. 726, 731-32 (1963) ("We refuse to sit as a 'superlegislature to weigh the wisdom of legislation' . . . . Whether the legislature takes for its textbook Adam Smith, Herbert Spencer, Lord Keynes or some other is no concern of ours.").

[6] *See, e.g., Pennell v. San Jose*, 485 U.S. 1, 11, 14 (1988) (proper standard of judicial review of legislative rent control is deferential); *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 388 (1926) ("If validity of legislative classification for zoning purposes is fairly debatable, the legislative judgment must be allowed to control").

> Responding to evidence that producers and refiners were favoring company-operated stations in the allocation of gasoline and that this would eventually decrease the competitiveness of the retail market, the State enacted a law prohibiting producers and refiners from operating their own stations. Appellants argue that this response is irrational and that it will frustrate rather than further the State's desired goal of enhancing competition. But . . . this argument rests simply on an evaluation of the economic wisdom of the statute, and cannot override the State's authority "to legislate against what are found to be injurious practices in their internal commercial and business affairs . . . . " *Id.* at 124 (citations omitted).

In *Agins*, however, this Court set the stage for a potentially different standard of judicial review of economic regulation. In that case, the Court reintroduced a means-ends test for land use regulation, but under the Takings Clause. The Court held that the application of a zoning law to property effects a taking if the law "does not substantially advance legitimate state interests." 447 U.S. at 260.[7]

The substantially advance test conflicts with the plain language of the Takings Clause, which requires the payment of compensation for taking of private property for public use. It is difficult to discern how the failure of a regulation to fulfill a valid public purpose could "take" property. Before *Agins*, the Takings Clause had never been understood as a substantive limit on governmental power.

[7] While *Agins* and the vast majority of regulatory takings cases concern land, the Takings Clause has been applied to other types of property. *See, e.g., Eastern Enterprises, Inc. v. Apfel*, 524 U.S. 498 (1998) (plurality applying Takings Clause to statute imposing obligation to pay money). The substantially advance test potentially applies to every type of economic activity involving private personal or real property.

As one commentator observed, the Framers of the Constitution did not intend the Takings Clause

> to impose a substantive limit on congressional expropriations. Rather, they intended to distinguish a certain type of taking which required compensation (expropriations) from those which did not (taxes and forfeitures). In essence, the drafters merely intended to ensure that compensation was given when a citizen was called upon to contribute more than his fair share to support the government. . . . [I]f read properly, the expropriation clause of the Fifth Amendment is nothing more than a compensation clause. Matthew P. Harrington, *"Public Use" and the Original Understanding of the So-Called "Takings" Clause*, 53 HASTINGS L.J. 1245, 1248-49 (2002)

See also Eastern Enterprises, 524 U.S. at 545 (Kennedy, J., concurring and dissenting) ("the Takings Clause . . . has not been understood to be a substantive or absolute limit on the Government's power to act"); *id.* at 554 (Breyer, J., dissenting) ("[A]t the heart of the Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing compensation for legitimate government action that takes 'private property' to serve the 'public' good.").

Moreover, the substantially advance test lacks any basis in takings jurisprudence. In *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 127 (1978), the Court first referred to a means-ends test under the Taking Clause in reliance on two due process cases, *Nectow v. Cambridge*, 277 U.S. 183 (1928) and *Moore v. East Cleveland*, 431 U.S. 494 (1977). Two years later, in *Agins*, the Court formalized this means-ends test for a taking, once again relying on *Nectow*. *Agins*, 447 U.S. at 260. No takings decision of this Court supports grafting a means-ends test to the Takings Clause. To the contrary, the substantially advance test directly conflicts with other decisions of this Court. In *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987) the Court unanimously held that takings analysis is not concerned with

the effectiveness of legislation. *Id.* at 487 n.16; *id.* at 511 n.3 (Rehnquist, J., dissenting). And in *Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229 (1984), the Court concluded that courts should defer to the legislative determination of public purpose in direct condemnation actions. *Id.* at 242. There is no principled reason to depart from that rule in inverse condemnation.

Despite the questionable origins of the *Agins* substantially advance test, this Court has not entirely repudiated the test, and the lower courts have been compelled to apply the test, simultaneously entreating this Court to end the confusion as to the test's validity and meaning. *See, e.g., Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993, 1013 (Cal. 1999), *cert. denied*, 526 U.S. 1131 (Kennard, J., concurring) ("Outside the *Nollan/Dolan* context, should a means-end test be used to determine whether a taking has occurred, or instead should means-end testing remain within due process jurisprudence? Only the high court can resolve this question and, given the importance of this area of the law, I suggest that it do so when the opportunity next arises.") *Chevron* provides an ideal vehicle for the Court to reject the test, end the confusion as to the role of the courts in economic policy-making, and restore the means-ends inquiry to its proper place under the Due Process Clause.

Even if the Court does not repudiate the substantially advance test, it should grant review to settle the meaning of the test. Since the Court decided *Agins*, different standards of judicial review have evolved under the substantially advance test. Nondeferential review of the type employed here by the Ninth Circuit, known as "heightened scrutiny," applies to "exactions" imposed on a case-by-case basis – where the government conditions approval on an owner's dedication of land to the public to offset the impact of a proposed project. *Nollan*, 483 U.S. at 841; *Dolan*, 512 U.S. at 385. Heightened scrutiny imposes the burden on the government to "make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Dolan*, 512 U.S. at 391. Heightened scrutiny

arises from the Court's concern that, in cases of unique, discretionary, adjudicatory exactions imposed on individual applications, the danger exists that the public agency might improperly leverage its police power by requiring an individual property owner to bear more than its share of responsibility for the burdens caused by development. *Nollan*, 483 U.S. at 841; *Dolan*, 512 U.S. at 385.

The Court has also found that heightened scrutiny is appropriate for administratively imposed exactions of real property interests because such regulations resemble physical takings. *See Nollan*, 483 U.S. at 831; *see also Dolan*, 512 U.S. at 385.

In contrast, this Court has indicated that a deferential standard continues to apply to legislative land use regulations that are generally applicable because the risk of the use of the police power to exact unconstitutional conditions is not present. *Nollan*, 483 U.S. at 834-35; *see also Dolan*, 512 U.S. at 385 (courts do not apply heightened scrutiny to regulations that "involve[] essentially legislative determinations classifying entire areas of the city"). The implicit justification for this distinction is that classes of property owners have greater power to influence land use policy in the legislative process and thus require less protection from government overreaching than do individual property owners engaged in administrative, adjudicatory decision-making proceedings. *See id.*

Consistent with *Nollan* and *Dolan*, five justices in *Eastern Enterprises* held that courts should apply deferential review to the substance of generally applicable legislation. Significantly, a majority of the justices rejected the notion that the "substantially advance" prong of *Agins* enunciated a freestanding takings test outside the *Nollan/Dolan* context of administratively compelled dedications of land. Five justices indicated that the deferential substantive due process test, rather than a takings analysis, should be applied to a law requiring the payment of money. 524 U.S. at 545-46 (Kennedy, J., concurring and dissenting), 554-58 (Breyer, J., dissenting, joined by Stevens, Souter, and Ginsburg, JJ.). As Justice Kennedy

stated, the wisdom of governmental action that does not require the dedication of possessory interests in real property is more appropriately analyzed under "general due process principles rather than under the Takings Clause." *Id.* at 545 (Kennedy, J., concurring and dissenting).[8]

In *Del Monte Dunes*, this Court observed that it had thus far applied heightened scrutiny only in "the special context of exactions." 526 U.S. at 702. The Court held that heightened scrutiny was not intended to apply to denials of individual development applications. *Id.* at 702-03; *see also id.* at 723 (Scalia, J., concurring); *id.* at 733 (Souter, J., dissenting, joined by O'Connor, Ginsburg, and Breyer, JJ.). The Court allowed the jury to determine whether the City of Monterey's conduct "substantially advances legitimate public interests" under the Takings Clause only because the city did not object to a jury instruction allowing that question to be put to the jury. *Id.* at 721-22.

Although this Court has signaled that the substantially advance test does not raise the standard of judicial review for economic legislation generally, it has not definitively resolved the issue, engendering considerable confusion in the lower courts. The Court should grant review in this case to settle this issue.

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[8] Other circuit courts have treated as binding this Court's five-four holding in *Eastern Enterprises* that the Takings Clause is not a substantive limit on the state's police power. In *Commonwealth Edison Company v. United States*, 271 F.3d 1327 (Fed. Cir. 2001), *cert. denied*, 535 U.S. 1096 (2002), the court observed: ["F]ive justices of the Supreme Court in *Eastern Enterprises* agreed that regulatory actions requiring the payment of money are not takings. We agree with the prevailing view that we are obligated to follow the views of that majority." *Id.* at 1339-40; *see also Unity Real Estate Co. v. Hudson*, 178 F.3d 649, 658-59 (3d Cir. 1999), *cert. denied*, 528 U.S. 963 (lower courts "are bound to follow the five-four vote (in *Eastern Enterprises*) against the takings claim. . . . "); *Kitt v. United States*, 277 F.3d 1330, 1336-37, *mod. on other grounds*, 288 F.3d 1355 (Fed. Cir. 2002) (same).

B. Circuit Court Decisions Conflict as to the Legitimacy and Scope of the Substantially Advance Test.

Conflict among the decisions of the circuit courts is also grounds for granting certiorari. Supreme Court Rule 10. Despite this Court's clear indication that legislative regulations should not receive heightened scrutiny, the circuit courts and the state courts have issued decisions that conflict with *Chevron* as to both the legitimacy and meaning of the substantially advance test. *Compare Simi Investment Co. v. Harris County*, 256 F.3d 323, 323 & n.3 (5th Cir. 1998) (*on pet. for rhrg. en banc*), *cert. denied*, 534 U.S. 1022 (2001) (whether ordinance is "illegitimate or arbitrary" is inquiry under Due Process Clause, not Takings Clause); *New Port Largo, Inc. v. Monroe County*, 95 F.3d 1084, 1088 (11th Cir. 1996), *cert. denied*, 521 U.S. 1121 (1997) (heightened scrutiny not applicable to zoning regulation that does not compel a physical invasion); *Texas Manufactured Hous. Ass'n v. Nederland*, 101 F.3d 1095, 1105 (5th Cir. 1996), *cert. denied*, 521 U.S. 1112 (1997) (rejecting application of *Nollan* to legislation regulating location of manufactured homes); *Clajon Production Corp. v. Petera*, 70 F.3d 1566, 1578 (10th Cir. 1995) (heightened scrutiny inapplicable to hunting license scheme because regulation not a "physical taking or its equivalent"); *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334, 343 & n.1 (N.J. 2001), *cert. denied*, 535 U.S. 1077 (2002) ("The Takings Clause 'is designed not to limit the governmental interference with property rights per se but rather to secure compensation in the event of otherwise proper interference amounting to a taking.'"); *Bonnie Briar Syndicate, Inc. v. Town of Mamaroneck*, 721 N.E.2d 971, 974-75 (1999), *cert. denied*, 529 U.S. 1094 (2000) (heightened scrutiny does not apply to downzoning); *Santa Monica Beach*, 968 P.2d at 1001-02 (Cal. 1999) (deferential standard applies to regulations that are "generally applicable through legislative action"), *with Richardson v. City and County of Honolulu*, 124 F.3d 1150, 1165-66 (9th Cir. 1997), *cert. denied*, 525 U.S. 871 (1998) (applying heightened scrutiny to legislative rent control); *Chevron I*, 224 F.3d 1030 (same); *Chevron II*, 363 F.3d 846 (same); *Northern Illinois Home Builders Ass'n v. County of DuPage*, 649 N.E.2d 384, 389 (Ill. 1995) (heightened scrutiny applicable to legislative development impact fee); *Trimen Development Co. v. King County*, 877 P.2d 187, 194 (Wash. 1994) (same); *Manocherian v. Lenox Hill Hospital*, 643 N.E.2d 479, 482 (N.Y. 1994), *cert. denied*, 514 U.S. 1109 (1995) (applying heightened scrutiny to rent control legislation).

Chevron even contradicts prior authority from the Ninth Circuit. *See Schnuck v. City of Santa Monica*, 935 F.2d 171, 175 & n.5 (9th Cir. 1991) (evidence that "many economists believe that imposition of rent ceilings for other than short emergency periods tends to reduce housing quality and quantity . . . calls into question the wisdom of the Rent Control Law, but not its constitutionality"); *Commercial Builders v. City of Sacramento*, 941 F.2d 872, 874 (9th Cir. 1991) (*Nollan* does not change deferential standard of review of legislative land use regulations "that do not constitute a physical encroachment on land."); *Garneau v. City of Seattle*, 147 F.3d 802, 817-18 (9th Cir. 1998) (Williams, J., concurring) (substantially advance claim properly reviewed under substantive due process, not takings); *Hotel & Motel Ass'n v. City of Oakland*, 344 F.3d 959, 968 (9th Cir. 2003) (ordinance substantially advanced legitimate state interest where reasonable relationship existed between regulation and public purpose); *San Remo Hotel v. City and County of San Francisco*, 364 F.3d 1088, 1097-98 (9th Cir. 2004) (deferential review applies to development impact fee challenged under substantially advance test). And an *en banc* panel of the Ninth Circuit recently adopted the majority view in *Eastern Enterprise* that substantive review of legislative regulations is not appropriate under the Takings Clause:

> The Takings Clause was never intended to replace the role of the people in determining which social programs are appropriate, and "has not been understood to be a substantive or absolute limit on the government's power to act. That Clause operates as a conditional limitation, permitting the government to do what it wants so

long as it pays the charge." *Eastern Enters.*, 524 U.S. at 545 (Kennedy, J., concurring in judgment and dissenting in part). *Washington Legal Foundation v. Legal Foundation of Washington*, 271 F.3d 835, 856 (9th Cir. 2001) (*en banc*), *cert. granted*, 536 U.S. 903 (2002).[9]

In 1992, in *Yee v. City of Escondido*, 503 U.S. 519, this Court foreshadowed the controversy surrounding the substantially advance test. In *Yee*, the Court declined to consider a substantially advance challenge to a mobile home rent control ordinance in part because "[t]he lower courts have not reached conflicting results . . . on whether similar mobile home rent control ordinances effect regulatory takings." *Id.* at 537-38. Since *Yee*, however, the lower federal and state courts have reached conflicting results on the level of judicial review of mobile home and other rent control. *Compare Cashman v. City of Cotati*, 374 F.3d 887, 897 (9th Cir. 2004) (applying heightened scrutiny to find mobile home rent control fails substantially advance test); *Chevron II* (applying heightened scrutiny to rent control); *Richardson v. City and County of Honolulu*, 124 F.3d 1150, 1166 (9th Cir. 1997) (same), *with Ventura v. City of San Buenaventura*, 371 F.3d 1046, 1055 (9th Cir. 2004) (rejecting constitutional challenge to mobile home rent control because ordinance "is at least rationally related to legitimate state interests"); *Levald, Inc. v. City of Palm Desert*, 998 F.2d 680, 690 (9th Cir. 1993) (rejecting constitutional challenge to mobile home rent control because "[h]ow well the ordinance serves [its] purpose[s] is a legislative question"); *Montclair Parkowners Assoc. v. City of Montclair*, 90 Cal.Rptr.2d 598, 605 (Cal.App. 1999) (expressly rejecting holding in *Richardson*, finding that mobile home rent control satisfies substantially advance test); *Sandpiper Mobile Village v. City of Carpinteria*, 12 Cal.Rptr.2d 623, 628-29 (Cal.App. 1992), *cert. denied*, 507

[9] The Supreme Court did not grant certiorari on the substantially advance issue.

U.S. 1032 (1993) (mobile home rent control satisfies substantially advance test). Mobile home rent control is merely one of many types of economic regulation that has been thrown into chaos as a result of the uncertainty surrounding the substantially advance test.

This Court has not definitively resolved either the legitimacy or the scope of the substantially advance takings test, particularly as it applies to generally applicable economic regulation. It is imperative that the Court grant review in this case to establish a uniform standard of judicial review of economic regulation.

II. THIS COURT SHOULD PRESERVE THE AUTHORITY OF ELECTED LEGISLATURES TO DECIDE THE WISDOM AND EFFICACY OF ECONOMIC REGULATION.

A reversal of *Chevron* is critically important for *amici* cities. The cities – like the state and federal government – have enacted scores of laws regulating economic activity to promote the general health, safety, and welfare and continue to enact such regulations daily. *Chevron* invites legal challenges to every one of these regulations as a "taking."

Chevron allows aggrieved property owners, and indeed, businesses of all kinds, to avoid the political process entirely. If the decision stands, courts could be permitted to assume the role of legislatures, and the public would be denied a voice in matters that have direct and immediate impact on their health, safety, property values, economic welfare, and quality of life. The framers of the Constitution could not possibly have intended this result. This Court should therefore overrule *Chevron* and establish a standard of review of economic regulation that preserves traditional deference to the policy decisions of legislative bodies, whether federal, state or local.

A. *Chevron* Conflicts with Representative Democracy.

The Constitution embodies the doctrine of separation of powers between the legislative and judicial branches. The separation of powers protects decisions of the legislature from "lateral attack by another branch." *Gorieb v. Fox*, 274 U.S. 603, 608 (1926). The legislative and executive branches hold authority to make social and economic policy. As the Supreme Court has consistently recognized in cases involving the powers of the other branches, the Constitution limits the role of the judiciary to restraining the *arbitrary* exercise of legislative authority. *E.g.*, *Dolan*, 512 U.S. at 391 n.8.

To work effectively, a democratic system must allow citizens equal opportunity to control the decision making agenda. ROBERT A. DAHL, DEMOCRACY AND ITS CRITICS 112-13 (1989). Each citizen must also possess the right to express preferences for a decision, meaning that each citizen's vote should receive equal weight. *Id.* at 109. Majority rule promotes this self-determination. "[T]he strong principle of majority rule ensures that the greatest possible number of citizens will live under laws they have chosen for themselves." *Id.* at 138.

One of the primary roles of the judiciary is to rein in the excesses of the other branches of government. The judiciary ensures that legislative enactments are within the Constitution. ROBERT A. DAHL, HOW DEMOCRATIC IS THE AMERICAN CONSTITUTION? 153 (2001). The role of the courts in reviewing legislation to protect fundamental liberties is well established. *Id.* When courts venture outside this realm into policy making that does not implicate fundamental rights, however, the courts frustrate democratic ideals. *Id.* at 153-54. Allowing judges to review legislative policy under a test as standardless as the means-ends takings analysis applied in the instant case creates the risk that their personal philosophical beliefs will color their decisions. *See* NEIL DUXBURY, PATTERNS OF AMERICAN JURISPRUDENCE 272-76, 473-74 (1995) (highlighting risks of judicial activism).

Once accepted, judicial review of legislation under the substantially advance test has no principled stopping point. And placing power in the hands of an unelected, life-tenured judiciary to declare that regulations are takings on the grounds that they will not achieve their avowed purpose conflicts sharply with self-governance. In recognition of these hallmark principles of our democratic system of government, this Court has sharply limited the authority of judges to interfere with legislative control of economic activity, by confining searching judicial review to regulations that affect fundamental rights. *See, e.g.*, *Williamson v. Lee Optical Co.*, 348 U.S. 483, 488 (1955).

Act 257 does not implicate fundamental rights. Accordingly, the determination that the regulation will achieve some legitimate state interest should be subject to the sound discretion of the legislature. Whether a price control such as that at issue here will have its intended effect in a complex industry may be debated in lengthy legislative committee hearings, in which economists, consumer advocates, industry participants, and even individual legislators present divergent views on the question. Along with that gathering of evidence, legislators weigh the opinions of constituents affected by the proposed regulation, and then fashion a policy intended to promote the general health, safety, and welfare.

Predicting the impact of price controls in a complex business such as the motor fuel industry is quintessentially a legislative policy function. The courts have no greater right to legislate this policy than they have to dictate zoning decisions, safety requirements for autos, or the proper procedure for pasteurizing milk. In this case, by extending no deference to the State Legislature of Hawaii on a question of economics, the district court assumed a legislative role. Had the district court based its decision on past effects on retail gasoline prices, the court would nonetheless have usurped the legislature's policy making function. But here, the district court engaged in a particularly egregious violation of the separation of powers by sustaining a *facial* challenge to the Act. The trial court *predicted* that the Act *would have* particular effects. The

expert testimony predicting the effects of the Act was not "evidence," however, nor were the district court's rulings findings of "fact" or conclusions of "law." *See* App. at 32, 50. The expert testimony on which the district court here relied was little more than speculation as to the effects of the Act. The court simply embraced one economic theory over another. *See* App. 43. In any event, the process of determining economic policy by predicting the economic effects of proposed regulation is fundamentally a legislative function. It is not a function the courts are well-equipped to perform and it is outside of their proper adjudicative role.

Chevron raises the potential for abuse of judicial power with regard to all government regulation, not merely price controls. If *Chevron* were allowed to stand, then the deferential rational basis test, historically applicable to economic legislation, would be eviscerated. The court's proposal in *Chevron* that the federal courts should conduct their own evidentiary hearings to predict the effects of legislation takes a page directly from *Lochner*.[10]

B. *Chevron* Will Promote Inefficiency and Chaos in Economic Policymaking.

If courts were the final arbiters of economic policy, the legislative enactment of an economic policy would mark only the beginning of the decision making process. The validity of any policy would remain unsettled for years as challenges to the legislation wound their way through the courts. Removing certainty as to the validity of economic

[10] The *Chevron I* majority noted that its decision should be narrowly applied and that it "save[s] for another day the question of whether the 'substantially advances' test applies outside the context of rent control statutes that permit the capture of a premium." 224 F.3d at 1036 n.4. But the court's reasoning that legislatures cannot be entrusted to make policy with respect to the economic relations between commercial landlords and tenants could be easily expanded to apply to all regulation that affects the value of assets.

regulation would chill business and real estate investment.

Moreover, the nondeferential standard of judicial review would flood the courts with lawsuits by business and property owners, as virtually any economic regulation would be subject to challenge as a taking. The government could be compelled to defend thousands of laws in evidentiary proceedings, at colossal cost to the taxpayers.

Nor do the courts have the institutional competence to study and mediate between competing interests in any industry – a function that is the essence of law making. A court confronted with a complex issue of economic regulation is no substitute for a local legislative agency that can see the larger picture in its jurisdiction or region. Economic regulations are often interdependent. Effective economic regulation requires a broader perspective than one isolated case at one point in time. Decisions as to the most effective economic policies are best made by legislatures taking the initiative to identify problems, receiving evidence from a wide range of affected parties and interest groups, debating the advantages and disadvantages of alternative policies, and compromising in order to reach a majority decision. A court with hundreds of cases on its docket is not the proper forum to make economic policy.

C. *Chevron* Will Encourage Forum Shopping and Multiply Litigation in the Federal Courts.

In *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 192-95 (1985), this Court held that a takings claimant must seek compensation in state court under state procedures before a federal takings claim arises. Contradicting *Williamson County*, however, the Ninth Circuit has held that a facial challenge to regulation on the ground that it does not substantially advance legitimate state interests is ripe in federal court even though the claimant has not sought compensation in state court. *Sinclair Oil Corp. v. County of Santa Barbara*,

96 F.3d 401, 407 (9th Cir. 1996), *cert. denied*, 523 U.S. 1059 (1998); *San Remo Hotel v. City and County of San Francisco*, 145 F.3d 1095, 1102 (9th Cir. 1998).

Although it is settled law in California that deferential judicial review applies to economic legislation challenged under the Takings Clause, *see San Remo Hotel*, 41 P.3d 87, 101-03 (Cal. 2002); *Santa Monica Beach*, 968 P.2d at 1001-02, *Chevron* applies nondeferential review. While most takings claims must be litigated in state court, *Chevron's* more favorable treatment of facial substantially advance claims will generate considerably more substantially advance takings challenges to legislation and induce many takings claimants to elect the federal forum, in defiance of *Williamson County*. The result would be confusion and inconsistent adjudications as between the federal and state courts. *Amici* cities would find it difficult to discharge their governmental functions under such uncertainty as to the standard of judicial review of their enactments. Moreover, the more generous federal forum for takings claims would inundate the federal courts with challenges to every manner of local economic regulation.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: September 3, 2004

Respectfully submitted,

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(6)

No. 04-163

SEP 3 - 2004

In The Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and MARK J. BENNETT, Attorney General of the State of Hawaii,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL LEAGUE OF CITIES, U.S. CONFERENCE OF MAYORS, INTERNATIONAL CITY-COUNTY MANAGEMENT ASSOCIATION, AND INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether a court may invoke the Just Compensation Clause to resurrect heightened scrutiny and invalidate State economic legislation through de novo second-guessing of the State's judgment as to the law's wisdom and efficacy.

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INTEREST OF THE *AMICI CURIAE*[1]

Amici's members include thousands of State and local legislators and other government officials throughout the United States. They are responsible for drafting, enacting, and administering laws and regulations in the public interest. These efforts include "the commendable task of land use planning," *Dolan v. City of Tigard*, 512 U.S. 374, 396 (1994), as well as a broad array of other regulatory initiatives that promote the public good. *Amici* thus bring a vital perspective to regulatory takings challenges to these protections, and we have submitted friend-of-the-court briefs to this Court in many takings cases. *See, e.g., Brown v. Legal Found. of Wash.*, 538 U.S. 216 (2003); *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302 (2002); *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987).

Amici's members have a compelling interest in preserving their police power authority to adopt reasonable land use laws, economic legislation, and other community protections, and in ensuring that courts refrain from improperly second-guessing the wisdom of legislative policy judgments. A grant of review and reversal in this case will eliminate the chilling effect produced by the

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[1] Counsel for the parties did not author this brief in whole or in part. No person or entity other than the *amici*, their members, and their counsel made a monetary contribution to the preparation or submission of this brief. The parties have consented to the filing of *amicus* briefs in connection with the petition for certiorari, and they filed letters reflecting consent with the clerk.

decision below, as well as the need for *amici*'s members to expend limited resources defending against challenges rooted in a level of scrutiny for economic regulation unprecedented in modern times.

ARGUMENT

I. Review Is Needed to Resolve the Federal and State Appellate Court Splits Over Whether the Just Compensation Clause Authorizes *Lochner*-Like Second-Guessing of Economic Regulation.

It is no exaggeration to say that the rulings below raise a question of historic proportions: May courts invoke the Just Compensation Clause to resurrect heightened, *Lochner*-esque scrutiny of economic regulation?

The trial court gave no deference to the State's legislative judgment and held that Act 257 does not substantially advance a legitimate interest. Pet. App. 50-53. It concluded that Act 257 would not benefit Hawaii consumers and thus violated the Just Compensation Clause because, in the court's view, the economic theories presented by Chevron were "more persuasive" than the State's position. *Id.* at 43. The Ninth Circuit affirmed, applying heightened scrutiny under the Just Compensation Clause (*id.* at 6-17, 58-66), expressly rejecting the rational basis test typically applied under the Due Process Clause (*id.*), and giving no deference to the views of the State legislature regarding the wisdom and efficacy of Act 257. *Id.* at 17-21.

Plain and simple, the lower courts invalidated Act 257 because they disagreed with the judgment of the State's elected lawmakers that the measure would protect Hawaii

consumers. The lower courts articulated a naked preference for Chevron's economic views and rejected the State's legislative judgment as to the efficacy of Act 257, just as the *Lochner* Court concluded that New York's worker protection laws were unwise. *See Lochner v. New York*, 198 U.S. 45, 53-54 (1905) ("The act must have a more direct relation, as a means to an end, and the end itself must be appropriate and legitimate, before an act can be held to be valid."). In other words, the lower courts imposed on Hawaii their own economic vision regarding the efficacy of Act 257, much as *Lochner* imposed Mr. Herbert Spencer's Social Statics on New York. *See Lochner*, 198 U.S. at 75 (Holmes, J., dissenting).

Since the demise of the *Lochner* era, courts generally have upheld economic regulation against constitutional challenge so long as there is a rational basis for the legislature to conclude that the challenged law advances a legitimate purpose.[2] This familiar rational basis test, while deferential, has some bite in appropriate cases.[3] As the Court well knows, the rational basis test is now firmly entrenched in our constitutional jurisprudence, and every Member of the Court has joined opinions criticizing the

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[2] *E.g., FCC v. Beach Communications, Inc.*, 508 U.S. 307, 309 (1993) ("The question before us is whether there is any conceivable rational basis justifying this [regulatory policy choice] for purposes of the Due Process Clause of the Fifth Amendment."); *Bowen v. Gilliard*, 483 U.S. 587, 602-03 (1987) (more searching scrutiny is appropriate only where government action impairs a fundamental right or targets a suspect class).

[3] *E.g., City of Cleburne v. Cleburne Living Ctr.*, 473 U.S. 432 (1996) (zoning ordinance excluding group homes for the mentally retarded lacked a rational basis); *Craigmiles v. Giles*, 312 F.3d 220 (6th Cir. 2002) (law permitting casket sales only by licensed funeral directors lacked a rational basis and thus violated the Due Process Clause).

more searching scrutiny of economic regulation that characterized the *Lochner* era.[4] Scholars, too, routinely refer to *Lochner* as reviled.[5]

And yet now in the Ninth Circuit – which comprises nine States and two territories, nearly 40 percent of the Nation geographically, and more than 51 million people[6] – federal courts are duty bound to use the Just Compensation Clause to engage in precisely the kind of policy second-guessing regularly denounced by courts and commentators. The lower courts did little more than swap the Just Compensation Clause for the Due Process Clause to justify this new judicial intrusion into economic policymaking, a point made clear by this Court's rejection of a due process challenge to a very similar law. *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978) (rejecting a due

[4] *See, e.g., College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 690 (1999) (Scalia, J., joined by Rehnquist, C.J., and O'Connor, Kennedy, and Thomas, JJ.) (referring to "the discredited substantive-due-process case of *Lochner*"); *id.* at 701 (Breyer, J., joined by Stevens, Souter, Ginsburg, JJ., dissenting) (describing *Lochner* as improperly limiting legislative flexibility without constitutional warrant).

[5] Robert H. Bork, *The Judge's Role in Law and Culture*, 1 Ave Maria L. Rev. 19, 21-22 (2003) (referring to *Lochner* as an "abomination"); David A. Strauss, *Why Was* Lochner *Wrong?*, 70 U. Chi. L. Rev. 373, 373 (2003) ("*Lochner v. New York* would probably win the prize, if there were one, for the most widely reviled decision of the last hundred years."); Judge Alex Kozinski, *Conduct Unbecoming*, 108 Yale L. J. 835, 871 n.254 (1999) (referring to *Lochner* as "the most reviled opinion since *Plessy v. Ferguson*").

[6] *Ninth Circuit Court of Appeals Reorganization Act of 2001: Hearing on H.R. 1203 Before the Subcommittee on Courts, the Internet, and Intellectual Property of the House Committee on the Judiciary*, 107th Cong. 36 (2002), at http://commdocs.house.gov/committees/judiciary/hju80880.000/hju80880_0f.htm (prepared statement of Idaho Attorney General Alan G. Lance).

process challenge to a law requiring oil companies to divest company-operated stations to maintain a competitive retail market for gasoline).

Amici do not make the *Lochner*-izing charge lightly, and we are aware that the term is sometimes bandied about so casually that users risk sounding like the boy who cried wolf. But here the lower courts enforced a pure judicial policy judgment on an economic issue that the Constitution leaves to elected legislators, the very essence of *Lochner* era jurisprudence. The wolf quite clearly is in the flock.

And like *Lochner*, the rulings below find no plausible basis in the text, structure, or original meaning of the Constitution. This Court has recognized that the Just Compensation Clause was originally understood as applying only to physical appropriations of property.[7] Although the Court has since extended the Clause to regulation that constitutes the functional equivalent of an expropriation, its text – "nor shall private property be taken for public use, without just compensation" – cannot reasonably be read as authorizing invalidation of economic regulation based on a means-end inquiry into the law's efficacy.

In fact, the text and structure of the Just Compensation Clause cut directly against the rulings below. The Clause requires that any taking be for a public use, a

[7] *See Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1014 (1992) ("[I]t was generally thought that the Takings Clause reached only a 'direct appropriation' of property * * * or the functional equivalent of a 'practical ouster of [the owner's] possession.'") (citations omitted); *id.* at 1028 n.15 ("[E]arly constitutional theorists did not believe that the Takings Clause embraced regulations of property at all.").

requirement that is satisfied if the legislature "rationally could have believed that the [legislation] would promote its objective." *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 242 (1984). It makes no sense to construe the Just Compensation Clause as also requiring a second means-end inquiry under heightened scrutiny to determine whether a taking occurred. The Ninth Circuit attempted to distinguish *Midkiff* by asserting that a more deferential standard was proper in that case because it involved a physical taking as opposed to economic regulation. Pet. App. 15-16. But this argument stands takings law on its head, for it is well-established that physical occupations receive greater scrutiny than regulation under the Just Compensation Clause. *See, e.g.*, *Tahoe-Sierra*, 535 U.S. at 321-24 (discussing the "longstanding distinction" between permanent physical occupations and regulations, with the former receiving categorical treatment and the latter being subject to a more complex analysis).

In view of the sheer size of the Ninth Circuit, the radical nature of its ruling by itself would justify review by this Court. But the case for review is made far stronger by the severe split of authority among the federal circuits and State high courts on the propriety of heightened means-end review under the Just Compensation Clause. As shown in the Petition (pp. 16-18), the Ninth Circuit has split from the Fifth, Eleventh, and Federal Circuits, as well as the highest courts of Florida, New Jersey, Rhode Island, and Washington, on the question of whether claimants can challenge the arbitrariness of government action under the Just Compensation Clause. The Petition (pp. 27-29) also demonstrates that the ruling below squarely conflicts with the First Circuit and the highest courts of California and New York regarding the proper

level of review under the ostensible "substantially advance" test.

These divergent rulings have prompted judges on both sides of the issue to call out for clarification by this Court. *Compare Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993, 1013 (Cal. 1999) (Kennard, J., concurring) ("Only the high court can resolve this question and, given the importance of this area of the law, I respectfully suggest that it do so when the opportunity next arises."), *with id.* at 1047 (Brown, J., dissenting) ("If such measures are capable of withstanding [means-end scrutiny under a] takings clause analysis, the high court ought to tell us so, preferably sooner rather than later.").

Amici's members in the States of California and Washington are especially concerned about the conflict between the Ninth Circuit and the highest courts of those States, splits that will encourage forum-shopping and generate confusion among government officials, the regulated community, and the public. More generally, *amici*'s members nationwide now face the burden of uncertainty created by a deep split among five federal appeals courts and six State high courts regarding the propriety of a means-end inquiry under the Just Compensation Clause, or the proper level of scrutiny for any such inquiry. Plainly, these are fundamental issues upon which national uniformity is desirable.

The Ninth Circuit's improper second-guessing of a legislative policy choice threatens not only similar regulation, but also countless other laws that will be challenged by claimants on the ground that they inadequately advance a legitimate goal. Future takings claimants almost certainly will argue there is no principled basis for limiting

heightened scrutiny to rent control cases, especially given that a principal case cited by the Ninth Circuit – *Agins v. City of Tiburon*, 447 U.S. 255 (1980) – is not a rent control case, but instead a workaday zoning challenge that purports to articulate a general test for takings liability.

While it is common for government-side *amicus* briefs in regulatory takings cases to list examples of laws that would be threatened by an adverse ruling, in this case the list could be virtually endless. It is difficult to imagine an economic or social regulatory provision that could *not* be challenged by an affected property owner in the hope that the court would second-guess the wisdom of the underlying policy choices, deem the law ineffective, and invalidate it under the Just Compensation Clause. The rulings below thus threaten the core federalism principle of preserving the role of States and their municipal subdivisions as laboratories of experimentation. *See New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

The implications of the Ninth Circuit's ruling are made all the more startling by the absence of economic harm to Chevron, which stipulated that Act 257 allows it to recover more rent in the aggregate from its lessee-dealer stations than it would otherwise charge, a rate of return that, in Chevron's words, "satisfies any Constitutional standards." Pet. 3 & n.2 (citing record). Because the Ninth Circuit's ruling does not turn on any showing of economic harm, countless State and local laws in the Circuit are now up for grabs, as claimants request judicial

second-guessing of those laws regardless of their economic effect.

The real-world impacts of the Ninth Circuit's ruling already are being felt. Just weeks ago, in *Cashman v. City of Cotati*, 374 F.3d 887, 896-99 (9th Cir. 2004), the Ninth Circuit relied on the ruling below to sustain a takings challenge to a mobile home ordinance because, in the court's view, the law did not substantially advance the public interest. The *Cashman* ruling prompted the dissent to lament the court's return to judicial activism: "We learned in the 1930s that economic regulation is generally done better by politically accountable legislators than by life-tenured judges. I regret to say that the Ninth Circuit is unlearning that painfully learned lesson." *Id.* at 905 (Fletcher, J., dissenting). And in *Committee for Reasonable Regulation of Lake Tahoe v. Tahoe Reg'l Planning Agency*, 311 F. Supp. 2d 972 (D. Nev. 2004), the court held that the Ninth Circuit's 2000 ruling in the instant case required heightened scrutiny of a local ordinance regulating the appearance of lakefront housing. *Id.* at 998-99. Given the invocation of the ruling below in a takings challenge to an aesthetic ordinance, it seems certain that future invocations will be limited only by the imagination of claimants' counsel.

As Justice Scalia observed in another context, means-end inquiries that go beyond rationality review are "flabby tests" that "invit[e] judicial arbitrariness and policy-driven decisionmaking." *Tennessee v. Lane*, 124 S. Ct. 1978, 2008-09 (2004) (Scalia, J., dissenting); *accord*, *Collins v. City of Harker Heights*, 503 U.S. 115, 125 (1992) ("As a general matter, the Court has always been reluctant to expand the concept of substantive due process because guideposts for responsible decisionmaking in this unchartered area are

scarce and open-ended."). Review here is necessary to restore proper respect for decisions by our elected State and local officials, and to prevent judicial policymaking under the guise of regulatory takings analysis.[8]

II. This Case Is an Exceptionally Good and Timely Vehicle for Clarifying the Confusion Among Federal and State Appellate Courts.

It is hard to conceive of a better case for resolving the disparate rulings among federal and State appellate courts regarding the purported means-end inquiry under the Just Compensation Clause. The trial record is fully developed. The ruling below cleanly frames the constitutional issues. The ruling conflicts with State high court rulings within the Ninth Circuit, thereby threatening the unfairness of forum-shopping and additional burdens on federal courts as claimants flock to the friendlier federal forum. And the issue has percolated among lower appellate courts to the point where judges on both sides of the question are calling out for clarification. *See* page 7, *supra* (discussing *Santa Monica*).

[8] *See Pegram v. Herdrich*, 530 U.S. 211, 221-22 (2000) (complicated factfinding and policy judgments "are not wisely required of courts unless for some reason resort cannot be had to the legislative process, with its preferable forum for comprehensive investigations"); *Chevron, U.S.A., Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 866 (1984) ("[F]ederal judges – who have no constituency – have a duty to respect legitimate policy choices made by those who do."); *Berman v. Parker*, 348 U.S. 26, 32 (1954) ("[T]he legislature, not the judiciary, is the main guardian of the public needs to be served by social legislation, whether it be Congress legislating concerning the District of Columbia, or the States legislating concerning local affairs."; citations omitted).

Just as important, Members of this Court repeatedly have identified this area of the law as confused and confusing. The Court articulated the substantially advance formulation in its terse 1980 opinion in *Agins*. For many years, it was largely ignored by lower courts. *E.g.*, *Bamber v. United States*, 45 Fed. Cl. 162, 165 (1999) (the substantially advance test "has not had a fruitful life" outside the narrow context of compelled dedications of land). In *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), four dissenting Justices stated flat out that the Just Compensation Clause "does not apply" to challenges to the reasonableness or efficacy of legislation,[9] and a fifth Justice declared the *Agins* means-end inquiry to be in "uneasy tension" with a proper understanding of the Clause.[10] All five concluded instead that only the Due Process Clause governed judicial examination into the statute's reasonableness and efficacy.[11]

The following year, in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), the Court

[9] *Eastern Enterprises*, 524 U.S. at 554 (Breyer, J., joined by Stevens, Souter, & Ginsburg, JJ., dissenting) (observing that the Just Compensation Clause "does not apply" to challenges to the legitimacy of legislation because "at the heart of the Clause lies a concern, not with presenting arbitrary or unfair government action, but with providing *compensation* for legitimate government action").

[10] *See id.* at 545 (Kennedy, J., concurring in the judgment).

[11] *Id.* at 545 (Kennedy, J., concurring in the judgment) ("[T]he more appropriate constitutional analysis arises under general due process principles rather than under the Takings Clause."); *id.* at 556 (Breyer, J., joined by Stevens, Souter, & Ginsburg, JJ., dissenting) (concluding there was "no need to torture the Takings Clause to fit this case" because issues regarding the reasonableness of government action find "a natural home in the Due Process Clause, a Fifth Amendment neighbor.").

acknowledged that it has never fully explained "the nature or applicability" of the substantially advance formulation outside the special context of compelled dedications of land, *id.* at 704, but it declined to clarify the doctrine because the issue had not been properly preserved. *Id.* Still, five Justices wrote or joined separate opinions expressly refusing to endorse the formulation as a legitimate test of takings liability.[12] As the Ninth Circuit recognized, the "varying opinions" and "inconsistent nature of the Court's precedent" in regulatory takings cases "suggest confusion" over whether the Just Compensation Clause authorizes heightened scrutiny of whether economic regulation adequately advances the public interest. Pet. App. 10.

The Ninth Circuit's use of the *Agins* substantially advance test to *invalidate* legislation further highlights the test's inherent dissonance. The purpose of the Just Compensation Clause is "to secure *compensation* in the event of otherwise proper interference" with property. *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 314-15 (1987). It is analytically discordant to strike down government action by invoking constitutional text that provides fair compensation for property expropriated for public use.

Of course, if a court were to award compensation upon concluding that a law did not advance the public interest,

[12] *Del Monte Dunes*, 526 U.S. at 732 n.2 (Scalia, J., concurring in part and concurring in the judgment) ("express[ing] no view as to [the] propriety" of the substantially advance formulation); *id.* at 753 n.12 (Souter, J., joined by O'Connor, Ginsburg, & Breyer, JJ., concurring in part and dissenting in part) ("offer[ing] no opinion" on whether the substantially advance formulation is correct).

the result would be even more bizarre. Such a law presumably would be improper because public officials are authorized to act only in the public interest. It makes no sense to say that an unauthorized law is cured by the payment of compensation to affected property owners, or that the public should pay when laws provide no benefit to the public. This anomaly in remedies demonstrates that the Due Process Clause, not the Just Compensation Clause, provides the appropriate framework for evaluating whether a law adequately advances a legitimate goal.

The history of the compensation remedy in regulatory takings doctrine helps explain how due process and takings analyses became conflated. Prior to 1987, certain commentators and courts believed that invalidation was a sufficient remedy for a regulatory taking.[13] As a result, there often was little need to distinguish between due process and takings analyses because violations of either clause led to invalidation. This Court frequently mixed the relevant terminology, referring to "takings of property without due process."[14] To further confuse the issue, the Just Compensation Clause applies to State and local governments through the Due Process Clause of the Fourteenth Amendment,[15] thereby encouraging a blurring of standards and phraseology.

[13] *E.g.*, Norman Williams, et al., *The White River Junction Manifesto*, 9 Vt. L. Rev. 193 (1984) (invalidation is an adequate remedy for violations of the Just Compensation Clause).

[14] *E.g., Metromedia, Inc. v. City of San Diego*, 453 U.S. 490, 498 n.7 (1981) (describing claims as alleging "takings of property without due process"); *Rostker v. Goldberg*, 453 U.S. 57, 61 n.2 (1981) (same); *Goldblatt v. Town of Hempstead*, 369 U.S. 590, 591 (1962) (same).

[15] *E.g., Dolan v. City of Tigard*, 512 U.S. 374, 383-84 & n.5 (1994) (citing *Chicago, B. & Q. R. Co. v. Chicago*, 166 U.S. 226 (1897)).

In 1987, the Court's landmark ruling in *First English* made clear that the government must pay just compensation for a taking, regardless of whether the taking occurs directly through the power of eminent domain or inversely through regulation that denies land economically viable use. 482 U.S. at 314-22. Although the government may limit its liability to temporary damages by rescinding the offending regulation (*id.* at 321), just compensation still must be paid.[16] Since the *First English* ruling, it has become far more important to distinguish between due process and takings due to the difference in remedy.

Worse still, the *Agins* Court derived its "substantially advance" formulation from the *Lochner* era's "substantial relation" standard for due process cases. *See Agins*, 447 U.S. at 260 (citing *Nectow v. City of Cambridge*, 277 U.S. 183, 188 (1928)). Although the demise of the *Lochner* era brought an end to heightened scrutiny of economic legislation under the Due Process Clause, heightened scrutiny improperly lives on under the Ninth Circuit's reading of *Agins*.

The five-Justice concurring and dissenting opinions in *Eastern Enterprises* constitute a candid acknowledgement that a due process means-end inquiry improperly crept into takings jurisprudence prior to *First English*. As Justice Kennedy recognized, the *Agins* substantially advance test results from a stark "imprecision" in regulatory takings doctrine, an imprecision rooted in "equivocal" assertions.

[16] There might be a narrow exception to the obligation to pay compensation for a taking where the challenged government action requires the claimant to pay money to a third party. *Eastern Enterprises*, 524 U.S. at 520-21 (plurality). This exception is inapplicable here.

Eastern Enterprises, 524 U.S. at 545-46 (Kennedy, J., concurring in the judgment). The Court should grant review here to clarify once and for all that means-end examinations of regulation should take place under the Due Process Clause, not the Just Compensation Clause.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and MARK J. BENNETT, Attorney General of the State of Hawaii,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE STATES OF NEW YORK, CALIFORNIA, COLORADO, CONNECTICUT, DELAWARE, ILLINOIS, IOWA, KENTUCKY, MAINE, MARYLAND, MINNESOTA, MISSISSIPPI, MISSOURI, MONTANA, OKLAHOMA, OREGON, UTAH, VERMONT, WASHINGTON, THE COMMONWEALTH OF PUERTO RICO, AND THE TERRITORIES OF GUAM AND THE VIRGIN ISLANDS AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo,* by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

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INTEREST OF THE *AMICI CURIAE*

This case presents two critical and related constitutional questions: (1) whether courts can use the Takings Clause to invalidate generally-applicable legislation that does not "substantially advance" a legitimate governmental interest; and (2) if so, whether they must conduct a *de novo* review of the statute's substantive validity to determine if it will in fact accomplish the government's stated purpose. The Ninth Circuit answered yes to both of these questions. If allowed to stand, its decision will authorize courts to substitute their own policy judgments for a legislature's, and in doing so, upset the careful balance of power that our federal system strikes between democratically-elected state and local institutions and the judiciary.

The *amici* States, Commonwealth, and Territories through their legislative and executive branches, routinely engage in many forms of regulation that affect economic interests. The challenges posed by new patterns of growth and development, a rapidly-changing economy, advances in science and technology, and increased understanding of public health risks and environmental harms require the states to respond and, on occasion, to experiment. The Ninth Circuit's ruling permits an assault on this prerogative by encouraging challenges under the Takings Clause that are premised on the so-called "means-ends" test mentioned in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980). But as this Court has recently indicated, it is far from clear whether legislation should even be subject to such a test under the Takings Clause.

The Ninth Circuit, however, not only adopted such a test but made it an exceedingly stringent one. Its decision requires a court to enjoin the operation of economic legislation under the Takings Clause if the court, after conducting a *de novo* review of the statute, concludes that the challenged law will not accomplish the legislature's intended goal. Left unaddressed, the Ninth Circuit's decision will severely constrain the options for a Legislature grappling with urgent and competing policy concerns. Courts will be required to closely scrutinize not the reasonableness of a regulation, but whether the legislative "means" chosen by the elected members of state government will, in the court's own view, achieve their "ends."

The ability of the states to enact not just land use and price control legislation, but also a potentially vast array of regulatory measures, including legislation regulating economic, environmental, health, or technological matters, will be irremediably compromised. The Ninth Circuit's decision threatens to establish the federal courts as overseers of state laws, routinely inquiring whether the state has made the "correct" policy choice to respond to a particular problem. This scheme would represent a sharp departure from the distribution of authority in our federal system and should be promptly addressed by this Court.

SUMMARY OF THE ARGUMENT

A grant of certiorari is warranted to review the Ninth Circuit's decision for several reasons. First, its determination that the Takings Clause subjects economic legislation to *de novo* judicial review for effectiveness conflicts with the decisions of other federal appellate courts and state high courts. Several of these courts have held that the Takings

Clause imposes no such requirement at all, concluding instead that such review of legislative judgments arises solely under the Due Process Clause. Other courts have held that the Takings Clause permits such review, but that it is deferential, requiring only that the legislation be rationally related to a legislature's purpose. This Court should grant the petition to resolve these conflicts.

Second, the Ninth Circuit's decision departs from this Court's own rulings. In *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), and *City of Monterey v. Del Monte Dunes, Ltd.*, 526 U.S. 687 (1999), a majority of this Court suggested that state legislation is not subject to any "means-ends" scrutiny under the Takings Clause. The Court has also made clear that if such scrutiny is authorized at all, the heightened review used by the Ninth Circuit is inappropriate when considering generally-applicable state legislation under the Takings Clause. In *Del Monte Dunes*, the Court indicated that "intermediate" scrutiny under the Takings Clause may be used only when reviewing an "exaction" — not a generally-applicable regulation, but a land-use decision conditioning approval of development on the dedication of property to public use. The Ninth Circuit's imposition of demanding *de novo* review also conflicts with this Court's ruling in *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470 (1987), which establishes that any substantive review that the Takings Clause may authorize is deferential.

Third, this case presents an issue of fundamental public importance that several courts have urged this Court to address. The Ninth Circuit's decision jeopardizes the ability of States to craft regulatory measures to meet the changing needs of their citizens. If left intact, it threatens a wide array of public protections, by means of the type of intrusive judicial review epitomized by *Lochner* and long ago discredited.

REASONS FOR GRANTING THE PETITION

I. THE COURT SHOULD GRANT CERTIORARI TO RESOLVE A CONFLICT AMONG THE LOWER COURTS AS TO WHETHER THE TAKINGS CLAUSE PERMITS JUDICIAL REVIEW OF THE SUBSTANTIVE VALIDITY OF ECONOMIC LEGISLATION AND HOW DEFERENTIAL ANY SUCH REVIEW MUST BE.

The decision below rests on two controversial constitutional premises: that the Takings Clause permits judicial review of the effectiveness of generally applicable-legislation, and that such review is not deferential, but rather a *de novo* scrutiny of whether, in the court's view, a statute will in fact achieve the Legislature's purpose. On both these points, the Ninth Circuit's decision conflicts with decisions of federal appellate courts and state high courts. Accordingly, a grant of certiorari by this Court is appropriate.

A. The Lower Courts Are in Conflict About Whether the Takings Clause Requires Judicial Review of the Substantive Validity of Generally-Applicable Legislation.

The Ninth Circuit's decision authorizing challenges to the substantive validity of generally-applicable state legislation under the Takings Clause conflicts with the rulings of three federal circuit courts and the highest courts of four states. The Takings Clause states that private property not "be taken for public use, without just compensation." In the view of the court below, this provision somehow requires the invalidation of all government action if it does not "substantially advance a legitimate state interest."

Chevron USA, Inc. v. Cayetano, 224 F.3d 1030, 1034 (9th Cir. 2000) (quoting *Agins*). This inquiry, according to the Ninth Circuit, mandates an intrusive "means/ends" review of policy judgments that have traditionally been reserved to democratically-elected institutions.

Other federal courts of appeals, recognizing that the Takings Clause by its terms imposes no such requirement, but rather only guarantees "just compensation" for a government taking, have reached a contrary conclusion. The Fifth Circuit has explained that challenges alleging that government interference with property interests is impermissibly "illegitimate and arbitrary" arise under the Due Process Clause, not the Takings Clause. *Simi Investment Co. v. Harris County*, 256 F.3d 323, 323 & n.3 (5th Cir.) (on petition for rehearing *en banc*) (citing *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998)), *cert. denied,* 534 U.S. 1022 (2001). Similarly, the Federal Circuit has held that "in a takings case we decide only whether the governmental action in question constituted a taking for which compensation must be paid." *Rith Energy, Inc. v. United States*, 270 F.3d 1347, 1352 (Fed. Cir. 2001) (refusing to consider the appellant's claim that the government's refusal to revise coal-mining permit because it was "driven by political pressure"). As to questions of legitimacy or efficacy, the Federal Circuit said, "we assume that the government action was lawful." *Id*; *see also Restigouche, Inc. v. Town of* Jupiter, 59 F.3d 1208, 1211 n.1 (11th Cir. 1995) ("We do not recognize ["substantially advance" takings claims] as distinct, viable federal constitutional claims in the zoning context."); *Bamber v. United States*, 45 Fed. Cl. 162, 166 (1999) (a claim that a government action fails substantially to advance a legitimate state interest "is not a takings claim").

The decision below also conflicts directly with the decisions of the high courts of four states, all of which have stressed that substantive challenges to the reasonableness of legislation do not lie under the Takings Clause. The New Jersey Supreme Court recently dismissed a takings claim — even though it found that the ordinance in question was "arbitrary, capricious and unreasonable" as applied to the plaintiff's property — on the ground that "[t]he Takings Clause 'is designed not to limit the governmental interference with property rights per se but rather to secure compensation in the event of otherwise proper interference amounting to a taking.'" *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334, 343 & n.1 (N.J. 2001), *cert. denied*, 535 U.S. 1077 (2002) (quoting *Eastern Enterprises*, 424 U.S. at 545). An invalid ordinance, the court said, does not present the "otherwise proper [governmental] interference that the Takings Clause presupposes." *Id.* at 343 (internal quotation omitted). Likewise, the Florida Supreme Court has emphasized the distinction between judicial invalidation of arbitrary government action, which arises under the Due Process Clause, and a judicial determination that a government action takes property without just compensation. *Tampa-Hillsborough County Expressway Authority v. A.G.W.S. Corp.*, 640 So.2d 54, 57 (Fla. 1994). Decisions from the Rhode Island and Washington Supreme Courts are to the same effect. *See Brunelle v. Town of South Kingston*, 700 A.2d 1075, 1083 n.5 (R.I. 1997) (rejecting conclusion that regulation may effect taking if it did not substantially advance legitimate state interest because "the arbitrariness or capriciousness of a particular state action is properly examined under the light of the Fourteenth Amendment due process clause and not the Fifth Amendment takings clause"); *Mission Springs, Inc. v. City of Spokane*, 954 P.2d 250, 261 (Wash. 1998) (claim of "[a]rbitrary or irrational refusal or

interference with processing a land use permit" properly analyzed under Due Process, not Takings Clause).

On the other hand, two other state high courts have joined the Ninth Circuit in using the Takings Clause to inquire whether a regulation "substantially advances" the government's objectives, thereby deepening the split on this important issue. *See State ex rel. Shemo v. City of Mayfield Heights*, 765 N.E.2d 345 (Ohio 2002) (finding zoning ordinances invalid as applied because they failed "to substantially advance" a legitimate interest, and concluding that ordinances therefore effected a compensable taking); *Sheffield Development Co., Inc. v. City of Glenn Heights*, __ S.W.3d __, 2004 Tex. LEXIS 195 (Tex. 2004) (applying *Agins* test of whether regulation "substantially advances legitimate state interests" to Texas Constitution's Takings Clause).

B. To the Extent the Takings Clause Authorizes Any Substantive Judicial Scrutiny of Economic Legislation, The Lower Courts Are Also In Conflict As To Proper Standard of Review.

The lower courts are just as sharply divided over the proper standard of review under the Takings Clause as they are about whether any scrutiny at all is appropriate. The Ninth Circuit held that the Takings Clause requires a searching *de novo* review of a challenged statute to determine whether or not it will in fact achieve the state's objectives — a standard, according to the Ninth Circuit, that is more rigorous than the traditional rationality review authorized by the Due Process Clause. This standard substantially diverges from the deferential standard adopted by the First Circuit and the highest courts of California and New York. This Court should

grant certiorari to confirm that if any substantive review of legislation is authorized by the Takings Clause, only the most deferential scrutiny is appropriate.

In reviewing the validity of a zoning regulation, the First Circuit concluded that the difference between a substantive due process claim and a takings claim was "largely a matter of semantics." *South County Sand & Gravel Co., Inc. v. Town of South Kingston*, 160 F.3d 834 (1st Cir. 1998). Under either provision, the court held, "[t]he dispositive question is whether the challenged legislation bears a rational connection to a legitimate public purpose." Any higher standard would "as[k] us to debate the effectiveness of municipal policy — and that is well outside our compass." *Id.* at 839; *see also Greenspring Racquet Club, Inc. v. Baltimore County*, 232 F.3d 887 (4th Cir. 2000) (table), *cert. denied*, 532 U.S. 957 (2001) (no room for independent judicial assessment of relationship of land-use regulations to their asserted purposes as long as "statements by . . . lawmakers set out legitimate reasons for imposing . . . restrictions on property"). By comparison, it is precisely "the effectiveness . . . of policy" that courts must scrutinize under the Takings Clause, according to the Ninth Circuit.

Likewise, in *Santa Monica Beach, Ltd. v. Superior Ct.*, 968 P.2d 993 (Cal.), *cert. denied*, 526 U.S. 1131 (1999), the California Supreme Court rejected an effort by the plaintiff to use the Takings Clause to engage in a intrusive review of legislative action. It held that the Takings Clause imposed not a "heightened intermediate scrutiny standard," but rather a test that asks only if the challenged regulation is "arbitrary" and whether it advances a "legitimate government interest" — even if that interest has not been identified by the legislature as a stated goal. *See id.* at 1004 (rejecting

application of heightened standard used in *Nollan* and *Dolan* to California rent control statute).[1]

The New York Court of Appeals has similarly refused to apply a heightened standard of review under the Takings Clause. In *Bonnie Briar Syndicate, Inc. v. Mamaroneck*, 721 N.E.2d 971 (N.Y. 1999), *cert. denied*, 529 U.S. 1094 (2000), a plaintiff seeking invalidation of a town land use ordinance argued that the town should be required to demonstrate a "close causal nexus" between the ordinance and the interests it sought to advance. *Id.* at 974-75. The court disagreed, requiring only that the ordinance bear a "reasonable relationship" to a governmental objective. *Id.* at 976 (declining to apply *Nollan*'s "essential nexus" standard outside context of exactions). A stricter standard, the court observed, would impermissibly infringe upon the legislature's prerogative to select the policy it deemed most appropriate: "it is not this Court's place to substitute its own judgment for that of the Zoning Board . . . [T]he question before us . . . is not the general wisdom or desirability of the regulation." *Id.* (internal quotation omitted). *See also Omya, Inc. v. Town of Middlebury*, 758 A.2d 777, 780 (Vt. 2000) (rejecting Takings Clause claim of substantive invalidity on grounds that substantive due process claim had already been rejected).

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1. This portion of the California Supreme Court's holding drew separate, pointed dissents from Justices Baxter, Chin, and Brown. *See id.* at 1026-1029 (Baxter, J., dissenting); *id.* at 1036-1038 (Chin, J., dissenting); *id.* at 1040-1042 (Brown, J., dissenting), all of whom argued for a higher standard akin to the one adopted by the Ninth Circuit.

II. THE OPINION BELOW CONFLICTS WITH THIS COURT'S PRECEDENTS.

A. A Majority of This Court Has Suggested That the Takings Clause Does Not Permit Judicial Review of the Substantive Validity of Generally-Applicable Legislation.

While there is uncertainty as to whether the Takings Clause permits judicial review of the substantive validity of generally-applicable legislation, five Justices of this Court have indicated that it does not. A grant of certiorari is appropriate to clarify this important area of law.

The "means-ends" test applied by the Ninth Circuit — whether a statute "substantially advances" the government's stated interest — was articulated in the context of the Takings Clause in *Agins*. *See also Penn Central Transp. Co. v. New York City,* 438 U.S. 104, 127 (1978). It has been applied in cases challenging permit conditions that required provision of public access to private property. *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987). But the Court has twice indicated that the test does not apply to generally applicable regulations, other types of permit conditions, or the denial of a permit. *Del Monte Dunes*, 526 U.S. at 702-03, 704; *Dolan*, 512 U.S. at 385, 391-393 & n. 8.

More broadly, a majority of the Court's members have indicated that the substantive Due Process Clause, not the Takings Clause, provides the appropriate avenue for such challenges. In *Eastern Enterprises*, four Justices stated that what lies "at the heart of the [Takings] Clause" is "a concern, not with preventing arbitrary or unfair government action,

but with providing *compensation* for legitimate government action that takes, 'private property' to serve the 'public' good." 524 U.S. at 554 (Breyer, J., dissenting). In addition, Justice Kennedy, concurring in the judgment and dissenting in part, wrote that *Agins's* "substantially advances" test "open[s] the door to normative considerations about the wisdom of government decisions . . . [t]his sort of analysis is in uneasy tension with our basic understanding of the Takings Clause, which has not been understood to be a substantive or absolute limit in the Government's power to act." *Id.* at 545 (invalidating challenged statute under Due Process Clause, rather than Takings Clause) (Kennedy, J., concurring in the judgment and dissenting in part).

One year later, in *Del Monte Dunes*, five Justices acknowledged that the Court had never provided "a thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions," but declined to address the question because it had not been raised below. 526 U.S. at 704. The other four Justices, while declining to reach the question of whether a challenge to a statute's substantive validity is "properly cognizable" under the Takings Clause, as opposed to the Due Process Clause, noted that the *Agins* means-ends test is "closely related to similar issues in substantive due process property claims." *Id.* at 753 (Souter, J., concurring in part and dissenting in part).[2]

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2. Three of these four justices already had indicated in *Eastern Enterprises* that "at the heart of the [Takings] Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for legitimate government action that takes 'private property' to serve the 'public' good." 524 U.S. 498, 554 (Breyer, J. dissenting) (emphasis in original).

The Ninth Circuit's reading of this Court's precedent as justifying broad application of the *Agins* test to economic legislation is untenable. None of the decisions relied upon by the Ninth Circuit transfer review of generally-applicable land-use regulation from the Due Process Clause to the Takings Clause.

B. The Ninth Circuit's Exacting Review of the Rent-Control Statute Involved In This Case Conflicts With the More Deferential Standard Required by this Court.

To the extent this Court has applied a means-ends test in reviewing Takings Clause challenges, it has used an extremely deferential standard, akin to the "rational relationship" test under the substantive component of the Due Process Clause. This Court should grant certiorari to make clear that if any substantive scrutiny is appropriate, it is this standard that applies.

This Court's decision in *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470 (1987), establishes that the Takings Clause, even if it entails some substantive review of a statute, does not permit heightened scrutiny of the statute's effectiveness. *Keystone* involved a Takings Clause challenge to a Pennsylvania statute that limited coal-mining activity. Although the court split sharply on the ultimate merits, it unanimously adopted a deferential standard of review. The majority upheld the statute because the Act "plainly [sought] to further" the substantial "public interest in preventing activities similar to public nuisances," *id.* at 492; the dissent, though persuaded that there was a compensable taking, noted that "our inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation,"

id. at 470 n.3. Rather, "'whether *in fact* the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature *rationally could have believed* that the [Act] would promote its objective.'" *Id.* (quoting *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 242 (1984) (quoting in turn *Western and Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 671-72 (1981))). None of the Justices suggested that a less deferential standard of review might be appropriate in a Takings Clause challenge to a generally-applicable state statute.

The Ninth Circuit attempted to locate such a requirement in *Del Monte Dunes*, which in fact stands for precisely the opposite proposition. There, the Court rejected the application of the "rough-proportionality" Takings Clause test "beyond the special context of exactions" at issue in *Nollan* and *Dolan*, which the Court had subjected to "intermediate" review. *See Dolan*, 512 U.S. at 390. Such heightened scrutiny, the Court held, was "inapposite" to a challenge "based not on exactions but on denial of development." 526 U.S. at 703. It is presumably even more "inapposite" to generally-applicable regulation of the sort at issue in the present case.

Although the law in this area is uncertain, it certainly will not support the Ninth Circuit's approach. *Keystone* and *Del Monte Dunes* establish that, if any judicial review of a statute's substantive validity is appropriate under the Takings Clause, the standard of review is deferential. This Court should grant certiorari to correct the Ninth Circuit's novel and unwarranted approach to this issue.

III. WHETHER THE TAKINGS CLAUSE PERMITS ANY SUBSTANTIVE REVIEW OF THE REASONABLENESS OF ECONOMIC LEGISLATION, AND IF SO, THE PROPER STANDARD OF REVIEW, IS AN ISSUE OF TREMENDOUS PUBLIC IMPORTANCE.

A great deal is at stake in this case. Amici States, as well as localities across the country, rely on a wide range of economic legislation, including land-use regulations, to protect the health and welfare of their citizens. The Ninth Circuit's decision threatens to complicate, perhaps even paralyze, these routine exercises of the police power.

Certiorari is appropriate here in part because of uncertainty as to whether the Takings Clause permits any analysis at all of the efficacy of generally-applicable economic legislation. As one member of the California Supreme Court noted in *Santa Monica Beach*, this question "remains an open one," and if the Clause authorizes application of a means-ends test, "the high court ought to tell us so, preferably sooner rather than later." *Santa Monica Beach, Ltd.*, 968 P.2d at 1047 (Brown, J., dissenting).

A grant of certiorari is also warranted because whatever the answer to this question, the standard of review used by the Ninth Circuit turns the Takings Clause on its head, and this Court should clarify that it has no application to a claim for just compensation. Even under the substantive component of the Due Process Clause, which plainly does permit limited judicial scrutiny of whether a statute might serve a government interest, review is highly deferential, asking only whether "it might be thought that the particular legislative measure was a rational way to correct [a particular problem],"

Williamson v. Lee Optical of Oklahoma, Inc., 348 U.S. 483, 487-88 (1955); *see Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 461-64, 470, n. 12 (1981). The Ninth Circuit instead imposed far more rigorous scrutiny, conducting a *de novo* and painstaking review of whether, in the court's view, the policy choice made by the Hawaii Legislature was the right one to advance its goals. Use of this standard of review would likely lead to the invalidation of numerous statutes and ordinances, and tie many more up for years in costly litigation. The result for the regulatory process could be disastrous. *See Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 535 U.S. 302, 335 (2002) (application of categorical rule to Takings Clause challenges alleging delay in property use rejected because it "would undoubtedly require changes in numerous practices that have long been considered permissible exercises of the police power").

The standard used by the Ninth Circuit is even more startling since the court below completely ignored the touchstone of regulatory takings jurisprudence — adverse economic impact. The notion that a regulation might effect a compensable taking evolved in response to concerns that it might "go too far" by imposing a severe economic impact on an individual in order to advance or protect the public good. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922). In the instant case, however, the Ninth Circuit determined that the Hawaii statute effectuated an uncompensated taking even though the affected property owners admittedly suffered *no* constitutionally-significant economic injury. 224 F.3d at 1041.

At the same time, the Ninth Circuit inadvisably enmeshed itself in "predictive" fact finding, 224 F.3d at 1039, an exercise for which it lacks institutional competence. Legislatures are better suited than courts to make predictions about the utility and effectiveness of a particular statute. Recognizing this fact, the Court, unlike the Ninth Circuit, has declined to engage in predictive economic fact finding. *General Motors Corp. v. Tracy*, 519 U.S. 278, 307-09 (1997) ("the Court is institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them").

Moreover, this Court has already rejected the type of intrusive judicial review authorized by the court below. Since the repudiation of *Lochner v. New* York, 198 U.S. 45 (1905), some seventy years ago, it has recognized that state legislatures possess the discretion necessary to craft reasonable solutions to evolving problems. Consistent with this historical understanding, this Court has held that "state legislatures have constitutional authority to experiment with new techniques; they are entitled to their own standard of the public welfare; they may within extremely broad limits control practices in the business-labor field." *Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421, 423 (1952). This Court should grant certiorari to confirm that amici States, as well as localities, may continue to do so without being second-guessed by the courts.

For the foregoing reasons, *amici curiae*, the States of New York, California, Colorado, Connecticut, Delaware, Illinois, Iowa, Kentucky, Maine, Maryland, Minnesota, Mississippi, Missouri, Montana, Oklahoma, Oregon, Utah, Vermont, Washington, the Commonwealth of Puerto Rico, and the Territories of Guam and the Virgin Islands, respectfully urge this Court to grant the Petition for a Writ of Certiorari.

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IN THE

Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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Act 257, Stat. § 486 H-10.4 (1997) 1

Miscellaneous:

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Senate Report No. 102-450 (1992) 4, 5

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INTEREST OF AMICUS CURIAE[1]

The Service Station Dealers of America ("SSDA") is a national nonprofit trade association which represents the interests of independent service station dealers located throughout the United States. SSDA was formed in 1948, and represents 20 state and regional affiliates, which in turn represent over 15,000 independent dealers in over 25 states. These independent dealers have a vital interest in supporting legislation such as Act 257, Haw. Rev. Stat. § 486 H-10.4 (1997), which is intended to provide long-term benefits to the citizens of Hawaii by ensuring that the State's retail market is preserved from the oligopoly that has already seized control of the State's wholesale market for gasoline.

REASONS FOR GRANTING THE PETITION

The constitutional arguments for granting the petition have been set forth fully in the Petition for a Writ of Certiorari and will not be repeated here. Rather, SSDA will limit itself to addressing the assumptions made by the courts below that there is no reason to believe that oil companies would attempt constructive eviction by charging high rent to their lessee-dealers and that, in any event, the Petroleum Marketing Practices Act ("PMPA"), 15 U.S.C. §§ 2801-2806, "already prevents an oil company from raising rents for the purpose of driving dealers out of business and converting the premises to company-operated stations." *Chevron U.S.A., Inc. v. Cayetano,* 198 F. Supp.2d 1182,

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[1] In compliance with Rule 37.6 of this Court, amicus curiae, the Service Station Dealers of America, states that no counsel for any party authored this brief in whole or in part and that no party or entity other than this amicus curiae, its members or its counsel made a monetary contribution to the preparation or submission of this brief.

1193 (D.Haw. 2002). *See also Chevron USA, Inc. v. Bronster*, 363 F.3d 846, 856 (9th Cir. 2004).

Major oil companies like Chevron enjoy enormous leverage over lessee-dealers such as those in Hawaii because they are the dealers' landlords, licensors and exclusive suppliers. The Senate Report accompanying the passage of the PMPA expressed concern with the problem of supplier dominance that is peculiar to the petroleum industry:

> The franchise relationship in the petroleum industry is unusual, in fact perhaps unique, in that the franchisor commonly not only grants a trademark license but also controls, and leases to the franchisee, the real estate premises used by the franchisee. In addition the franchisor almost always is the primary, even exclusive, supplier of the franchisee's principal sale item: motor fuel.

S.Rep. No. 731, 95th Cong., 2nd Sess., 17 (1978).

Typically, lessee-dealers will sink significant costs into their businesses based upon the reasonable assumption that their franchise and lease relationships will not be arbitrarily terminated or non-renewed. Their "reasonable expectations" in that regard were also noted in the PMPA Senate Report:

> It is also important to note that often the reasonable expectations of the parties to a motor fuel franchise are that the relationship will be a continuing one. This expectation by the franchisee, in particular, is often the result of, and fostered by, statements and actions of the franchisor. As a result, non-

> renewal of a motor fuel franchise relationship at the expiration of its term can be almost as punitive as termination of the franchise during its term. The reasonable expectations of the franchisee, rather than any definitive contract rights, are destroyed.

Id. at 18.

Of particular significance here is the district court's recognition of the pro-competitive role that independent lessee-dealers play in maintaining interbrand and intrabrand competition in what otherwise would be an oligopolistic market, such as Hawaii. The district court entered its factual finding that "[f]ewer lessee-dealer stations in the market means that retail prices will increase." 198 F. Supp.2d at 1192. The district court explained:

> In the first place, fewer lessee-dealers means greater concentration at the retail level, which means less intra-brand and interbrand competition. In the second place, the fewer lessee-dealers there are, the easier it is for wholesale gasoline suppliers to engage in cooperative pricing, leading ultimately to higher wholesale and retail prices.

Id. The court of appeals nowhere challenged the district court's finding of fact.

If the lower courts' assumptions that oil companies will not attempt to use high rents to eliminate independent lessee-dealers and that independent dealers are in any event protected from constructive eviction by the PMPA are open to doubt, then the legislature had a reasonable basis for protecting independent dealers from constructive eviction as

a means of preventing the upward impact on retail prices that the district court found would indeed occur as the result of diminished intrabrand and interbrand competition.

SSDA believes itself qualified to comment upon the lower courts' assumptions based upon its extensive knowledge of nationwide conditions in the retail gasoline market. In fact, what has been occurring throughout the retail gasoline market over the past twenty years, coupled with the failure of the PMPA -- as interpreted by numerous courts -- effectively to address the issue of constructive eviction, directly contradicts these assumptions.

Senate Report No. 102-450 (1992) contained an early warning about the major oil companies' use of their pricing power to evict their lessee-dealers in order to convert stations to company-operation. It observed:

> Oil companies need not engage in an overt "retail below wholesale" inversion in order to drive their dealers and distributors out of business. Instead, they simply raise the dealers' costs through increased rent, credit card charges, forced 24-hour operation, and the imposition of other costs of doing business that render the superior marketing efficiency of independent dealers and distributors meaningless.

Id. at 5.

Describing the intentions of one major oil company to decimate its dealers, as detailed in its own Strategic Planning Unit document, the Senate Report recounted ARCO's plans for the future of its "dealer apparatus":

> The "dealer apparatus" would have their costs raised by the implementation of "economic rents" which would raise rents by a factor of 300 to 400 percent. This increase would have two primary effects -- it would make the company indifferent, to a degree, to the sales of motor fuel by the dealers, and it would result in hundreds of dealers being forced out and replaced by company-operated stations. ARCO then planned to "keep prices low until the political resistance fades," and after that time, a "period of lasting, accepting profitability would occur."

Id. at 6. Summarizing the unhealthy trend that it perceived, the Senate Report concluded, "Any market in which the most efficient marketers are being driven out of business is not a healthy, competitive market." *Id.* at 4.

Two recent federal decisions found that Exxon had used its pricing power methodically to drive its own lessee-dealers out of business. In *Mathis v. Exxon Corp.*, 302 F.3d 448, 459 (5th Cir. 2002), the Fifth Circuit found that Exxon's Houston and Corpus Christi, Texas dealers had presented "ample evidence" to document Exxon's use of its pricing power to replace independent dealers with company-operations in Houston, and with jobber-supplied locations in Corpus Christi. The court said:

> Although Exxon decided to move to CORS [company-operated locations] in Houston and jobbers in Corpus Christi, this decision was not communicated to its franchisees. Because of profits from other sales, CORS could, and did, sell gas for less than the franchise dealers paid to Exxon for their gas.

> And the jobbers delivered Exxon gas to their dealers for less than Exxon franchisees were required to pay for their delivered gas, but Exxon prohibited its franchisees from buying at this lower price from the jobbers.
>
> Loss of competitive position and profit to plaintiff franchisees was inevitable and foreseeable to Exxon. Although Exxon witnesses denied receiving complaints, its dealers testified that they had complained often and for years, without success, until the very eve of trial.

Id.

In *Allapattah Services, Inc. v. Exxon Corp.*, 61 F. Supp.2d 1308, 1313 (S.D. Fla. 1999), *aff'd*, 333 F.3d 1248 (11th Cir. 2003), the district court denied Exxon's motion for summary judgment directed against a claim asserted by a nation-wide class of Exxon lessee-dealers that Exxon had evicted numerous of its dealers "by secretly dividing its dealers into 'keepers' and 'non-keepers,' while internally recognizing that its pricing practices were driving the 'non-keepers' out of business." Ultimately, the jury found for the dealer class after reviewing Exxon's own internal documentation, which confirmed its intent to price many of its own dealers out of business.

Such dealer victories have been rare and, significantly, were *not* achieved under the PMPA. Both *Mathis* and *Allapattah* attacked Exxon's destructive wholesale pricing of gasoline under Uniform Commercial Code § 2-305, which subjects the sale of goods pursuant to open-price-term contracts (such as dealer supply agreements) to a standard of commercial reasonableness. That provision

is not applicable, however, to excessive rent demands made by oil companies on a non-negotiable basis at the time of lease renewal, with the intent and/or effect of making it impossible for the lessee-dealer to continue to operate his or her station.[2]

The PMPA has *not* been effective in protecting independent dealers targeted for extinction through non-negotiable high rent demands at the time of lease renewal. This is because the pertinent statutory provision, 15 U.S.C. § 2802(b)(3)(A), only grants relief to a dealer who can prove that his or her supplier acted with subjective bad faith or with the express purpose of converting his or her station to company operation. As a result, so long as the oil company is not stupid enough to concede the true purpose of its high rent demands, the dealer is very unlikely to secure relief under the PMPA. *See, e.g., Duff v. Marathon Petroleum Co.*, 863 F. Supp. 622, 628 (N.D. Ill. 1994), *aff'd*, 51 F.3d 741 (7th Cir. 1995) ("Under the PMPA, Marathon does not need to prove that the rent increases were reasonable, only that they were made in the ordinary course of business and not as a pretext for termination of the franchise."); *Ackley v. Gulf Oil Corp.*, 726 F. Supp. 353, 368 (D. Conn.), *aff'd*, 889 F.2d 1280 (2d Cir. 1989) (rent increases of up to 761% not challengeable because it is not sufficient that rent formula "operate unreasonably in a particular case"); *Brown v. Magness Co.*, 617 F. Supp. 571, 575 (S.D. Tex. 1985) ("The fact that new provisions in a franchise agreement may make the station unprofitable for the lessee is not of itself

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[2] Some recent decisions have cut back on the enforcement of UCC § 2-305 by rejecting the relevance of evidence of an oil company's subjective intent to drive its dealers out of business through unreasonably high wholesale pricing. *See Tom-Lin Enters., Inc. v. Sunoco, Inc.*, 349 F.3d 277 (6th Cir. 2003); *Shell Oil Co. v. HRN, Inc.*, ___ S.W.2d ____ (Tex. Aug. 27, 2004). The impact of these decisions is to further weaken the ability of independent dealers to resist the oil companies' use of high wholesale pricing to force them from their businesses.

determinative of an improper purpose, nor does the fact that the new terms are presented on a take-it-or-leave-it basis constitute lack of good faith.") (internal citations omitted); *Meyer v. Amerada Hess Corp.*, 541 F. Supp. 321, 330 (D. N.J. 1982) (upholding rental increase of over 300%).

Loading the dice further against dealers seeking to challenge exorbitant rent demands presented to them on a non-negotiable basis by their oil company landlords, two circuits have recently held that dealers cannot sign leases "under protest" and commence PMPA litigation, but must risk non-rescindable notice of termination in order to mount a court challenge. *Abrams Shell v. Shell Oil Co.*, 343 F.3d 482 (5th Cir. 2003); *Dersch Energies, Inc. v. Shell Oil Co.*, 314 F.3d 846 (7th Cir. 2002). This means that if the dealer is unable to unmask the oil company's true subjective intent, he or she is out of business.

Further undermining the willingness or ability of independent dealers to mount a PMPA challenge is the virtually universal practice of oil companies of inserting in their form franchise agreements prevailing party attorneys-fees provisions or one-sided provisions requiring the dealer to pay the oil company's attorneys fees if his or her challenge is unsuccessful. To the dealer alone such attorneys fees are ruinous.

The net result of all this is that, in the real world, attempts by independent dealers to use the PMPA to challenge their suppliers' unreasonable take-it-or-leave-it rent proposals are rarely even attempted much less successful, which is totally inconsistent with the lower court's erroneous assumption that the PMPA "prevents an oil company from raising rent for the purpose of driving dealers out of business and converting the premises to company-

operated stations." *Chevon U.S.A.,* 198 F. Supp.2d at 1193. That, in the real world, simply is not so.

Unfortunately, SSDA lacks the ability and resources to document the exact extent through which the ranks of independent dealers have been thinned by the oil companies' exorbitant non-negotiable rent demands. From observation of the industry, however, SSDA submits that the impact has been very substantial. Typical of the extensive anecdotal evidence that it has received is the report last month from its New England affiliate:

> Shell has raised rents so much in Massachusetts and New Hampshire that the dealer population has been reduced by about 40% in the past three years. There is only one dealer left on Cape Cod, a few years ago there were dozens. Dealers exhausted their working capital, then resorted to loans and equity loans. Most eventually lost their businesses, some had buyers, but still went bankrupt because of the lengthy, cumbersome, subjective approval process [required by Shell to obtain its consent to assignment].
>
> Exxon is similar, may dealers got fed up and turned in the keys. All along intending to sell the business as a substantial part of their retirement savings.

In upholding the constitutionality of a Maryland divorcement statute intended to preclude oil companies from displacing independent dealers with company-operated stations, this Court stated:

> The evidence presented by the refiners may cast some doubt on the wisdom of the statute, but it is, by now, absolutely clear that the Due Process Clause does not empower the judiciary "to sit as a 'superlegislature to weigh the wisdom of legislation' ...." *Ferguson v. Skrupa*, 372 U.S. 726, 731 (citation omitted) ... Regardless of the ultimate economic efficacy of the statute, we have no hesitancy in concluding that it bears a reasonable relation to the State's legitimate purpose in controlling the gasoline retail market, and we therefore reject appellants' due process claim.

Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 124-25 (1978).

SSDA respectfully submits that due deference should similarly be shown to Hawaii's analogous determination that independent dealers should be preserved from extinction in order to promote interbrand and intrabrand competition in the retail gasoline market. This is particularly so because the lower courts' assumptions that oil companies will not use high rents to eliminate lessee-dealers and that those dealers are adequately protected by the PMPA are debatable at best; and, the district court itself recognized the substantial linkage between preserving interbrand and intrabrand competition at the retail level and protecting Hawaii's citizens against the threat of oligopolistic price gouging. *Chevron U.S.A.*, 198 F. Supp.2d at 1193. SSDA respectfully submits, therefore, that the lower courts' invasion of Hawaii's legislative province should be reviewed by this Court.

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IN THE

Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, AND MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON U.S.A. INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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SUPPLEMENTAL BRIEF FOR PETITIONERS

This Court's decision on September 28, 2004, to grant review in *Kelo v. City of New London, Connecticut*, No. 04-108, highlights the importance of the distinct, but closely-related questions raised by this case and makes the need for review in this case even more compelling. *Kelo* involves a challenge under the "public use" requirement to a municipality's exercise of eminent domain, whereas this case involves an allegation that state legislation constituted a regulatory taking because the law did not "substantially advance" a state interest. Although the two cases address different aspects of the Just Compensation Clause, they both involve the same fundamental question of whether and to what extent the Clause places substantive limitations (not simply compensation requirements) on government action. A grant of review in this case as well as *Kelo* would afford the Court

the opportunity to (1) provide a more cohesive clarification of the role of the Clause (if any) as a basis for invalidating governmental action and (2) avoid the confusion that might arise if the Court addressed this larger issue solely in the eminent domain context.

The close doctrinal relationship between the "public use" requirement and the purported "substantially advance" test for a regulatory taking makes a comprehensive resolution of these issues highly desirable. As the language of the Just Compensation Clause makes clear, the public use requirement applies both in condemnation cases and in inverse condemnation cases. Moreover, as this Court noted in *Brown v. Legal Foundation of Washington*, 538 U.S. 216 (2003), the requirement that a governmental exercise of the taking power serve a valid public use essentially looks to the "legitimacy" of the government's action, *id.* at 232. The public use requirement thus does involve an inquiry into the validity of governmental action, albeit under a highly deferential standard. In the decision below, however, the Ninth Circuit invoked the "substantially advance" test, which also involves an inquiry into the legitimacy of government action, not as a prerequisite for a taking claim, but as an independent test, based on a heightened standard of review, for determining whether a taking has occurred.

The two doctrines are thus in significant tension with each other: on the one hand, an action that does not serve a legitimate public use cannot effect a "taking" at all within the meaning of the Just Compensation Clause, whereas the "substantially advance" test ostensibly makes the alleged illegitimacy of government action the very basis for finding a taking. This case, taken with *Kelo*, offers the Court the chance to make clear that, in *every* taking case, the substantive validity of the government's action is a *threshold* requirement, encapsulated in the concept of public use, rather than a "touchstone to distinguish regulatory 'takings'—which require compensation—from regulatory deprivations that do not require compensation." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1026 (1992); *see also Palazzolo v. Rhode Island*, 533 U.S. 606, 635 n.* (2001) (O'Connor, J., concurring) (whether enactment or application of regulation constitutes a valid exercise of the police power is distinct from question whether government action requires payment of compensation).

A grant of review in this case as well as in *Kelo* also would be highly desirable because both cases raise distinct but related questions regarding the proper standard for judicial review of governmental actions under the Just Compensation Clause. In *Kelo*, petitioners embrace, as "one plausible means of giving the public use requirement substance" (*Kelo v. City of New London*, No. 04-108, Pet. 29), the position taken by the dissenting judges in the Connecticut Supreme Court that whether a proposed exercise of the taking power will provide public benefits should be determined as a question of fact, without deference to the legislature's judgment on that point, and under an elevated standard of review ("clear and convincing evidence"). *Kelo v. City of New London*, 843 A.2d 500, 588 (Conn. 2004) (Zarella, J., concurring in part and dissenting in part). In this case, the Ninth Circuit employed a similar approach to determine whether, as a matter of "predictive fact," Hawaii Act 257 would benefit the public. A grant of review in both cases will thus ensure that the standard of review under the Just Compensation Clause is developed in a cohesive fashion. The Court has already noted a linkage between the standard of review in the eminent domain context and in the regulatory takings context. Indeed, the Court's decisions suggest that the test for determining whether a state regulation is a regulatory taking should not involve heightened scrutiny of the validity of the regulation *precisely because* the public use doctrine imposes a (modest) requirement that the action be legitimate. *See Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 511 n.3 (1987) (Rehnquist, J., dissenting).[1] But as the decision of the Ninth Circuit in this

[1] Ironically, the Ninth Circuit's decision in this case also perceived a linkage between the standard of review for public use determinations and

case demonstrates, it is far from clear that the lower courts apprehend the proper relation between these two aspects of the Just Compensation Clause. As a result, and as the State's petition has shown, there is widespread doctrinal confusion in the lower courts about the proper standard to be used in applying the purported "substantially advance" test.

Finally, unless the Court grants review in this case as well as in *Kelo*, the confusion surrounding the "substantially advance" test will remain, and indeed might well be exacerbated, regardless of the outcome in *Kelo*. On the one hand, regardless of how the Court resolves the standard of review issue in *Kelo*, the lower courts may not be able to rely on that determination to resolve the confusion about the standard of review in the regulatory takings context.[2] On the other hand, to the extent the Court's resolution of the standard of review issue in *Kelo* would influence the standard applied by the lower courts in regulatory cases, the confusion and conflict in regulatory takings law may simply be compounded. The Court's recent decisions strongly suggest that the "substantially advance" test may not be a valid takings test at all. It would be awkward, at best, for the Court to offer even indirect guidance on the standard of review that should be used in applying a test that may not exist without addressing the underlying question of the validity of that test.

The Court should not decide *Kelo* based on possibly incorrect assumptions about whether means-ends scrutiny is

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that for alleged regulatory takings, albeit in the opposite direction: the Ninth Circuit believed that deferential review was appropriate for exercises of eminent domain accompanied by payment of just compensation for the affected property owner, but not for regulatory claims in which the question is whether the government *should* pay compensation. Pet. App. 15, 59-60.

[2] The Ninth Circuit, for example, perceived no conflict between a highly deferential standard of review for condemnation cases and a heightened standard of scrutiny under the purported substantially advance test for regulatory taking claims.

appropriate at all in this setting, a question on which this Court has repeatedly expressed its uncertainty. *See* Pet. 9-12. The State therefore respectfully submits that the Court should not hold this case for *Kelo*, but should grant review in this case as well and should set the two cases for oral argument together. A grant of review in this case as well as *Kelo* will provide the Court with the opportunity to give the lower courts guidance about the proper standard in all takings claims, whether involving per se takings such as eminent domain or alleged regulatory takings.

CONCLUSION

For these reasons, the State of Hawaii believes that this Court's grant of review in *Kelo* makes even more clear the need for granting certiorari in this case.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of this Court's rules, respondent Chevron U.S.A. Inc. ("Chevron") states that it is an indirectly wholly-owned subsidiary of ChevronTexaco Corporation, which is a publicly traded company, through the following intermediate entities: Chevron U.S.A. Holdings Inc., Texaco Inc., Chevron Asiatic Limited, Chevron Texaco Overseas Petroleum Inc., Texaco Exploration and Production Inc., and TEPI Holdings Inc.

SUPPLEMENTAL BRIEF FOR RESPONDENT

The issue raised by the Supreme Court of Connecticut's decision in *Kelo v. City of New London*, 843 A.2d 500 (Conn.) (en banc), *cert. granted*, No. 04-108 (2004), is unrelated to that raised by Hawaii's petition in this case. The decision below is no more worthy of *certiorari* when considered in conjunction with *Kelo* than it is standing alone.

1. As petitioners concede, Supp. Br. for Petitioners at 1, *Kelo* and the decision below involve distinct issues under the Taking Clause. *Kelo* addresses the "public use" requirement, U.S. Const. art. V, a threshold requirement that must be satisfied for a State to assert eminent domain power. The question there is whether it is a "public use" for the government to take a person's property for private economic development purposes — an issue this Court has not specifically addressed and on which the lower courts have reached sharply differing conclusions.

The decision below does not involve any question of "public use." Nor does it arise from a State's attempt to exercise its eminent domain power. Instead, it involves one strand of this Court's regulatory Taking jurisprudence, which applies where the State *refuses* to invoke its eminent domain power. The question in a regulatory takings case such as this is not whether the government is acting for a "public" purpose, but rather whether the regulation nonetheless "goes too far" in burdening private property interests in relation to that asserted public purpose. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

Although conceding that the issues are different, petitioners assert that they should be considered together because both involve "substantive limitations . . . on government action." Supp. Br. for Petitioners 1. But petitioners do not explain why the resolution of one of these

separate limitations should bear on the other. Nor is any such reason apparent. The "public use" requirement and the regulatory takings doctrine serve different purposes and protect differing interests. Unsurprisingly, *Kelo* does not even mention the substantial advancement test, and does not cite *Agins v. City of Tiburon*, 447 U.S. 255 (1980), *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), *Dolan v. City of Tigard*, 512 U.S. 374 (1994), or any other substantial advancement precedent. The purported connection petitioners seek to draw between the public use requirement and the regulatory takings doctrine, while perhaps fodder for academic musings, finds no basis in the decisions of this Court or the lower courts resolving actual cases under the Taking Clause.

2. Even if the two admittedly distinct issues were related, petitioners offer no persuasive reason why that supports granting *certiorari* in this case. Petitioners assert that resolution of the "public use" issue in *Kelo* might create "confusion" in the lower courts over the substantial advancement test. Such speculation, however, is no basis for granting *certiorari*. Given the differences between these separate aspects of takings analysis, the likelihood that this Court's ruling in *Kelo* will have any relevance to regulatory takings cases such as this is remote at best. But even assuming such relevance, petitioners identify no reason why this Court should depart from its normal practice of leaving such issues to be developed in the first instance in the lower courts and waiting to see whether any actual confusion or conflicting decisions arises. As our brief in opposition demonstrates, unlike the application of the public use requirement to condemnations for private economic development at issue in *Kelo*, the substantial advancement test has been specifically addressed and repeatedly reaffirmed by this Court and has not occasioned any split in the lower courts.

CONCLUSION

The petition for a writ of *certiorari* should be denied.

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JOINT APPENDIX

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RELEVANT DOCKET ENTRIES

U.S. District Court

U.S. District Court for the District of Hawaii (Hawaii)

Date	#	DOCKET ENTRY
7/21/97	1	COMPLAINT; exhibit "a"; summons (issued) (mm) [Entry date 07/25/97]
		* * *
7/25/97	5	FIRST AMENDED COMPLAINT[1-1] by plaintiff Chevron U.S.A. Inc.; exhibit "a"; summons (issued) (wn) [Entry date 07/28/97]
		* * *
9/8/97	12	ANSWER by defendant Benjamin J. Cayetano, defendant Margery S. Bronster to complaint filed on 7/21/97 and amended complaint filed on 7/25/97 [5-1]; certificate of service (wn)
		* * *
1/28/98	25	NOTICE OF MOTION and motion by plaintiff for partial summary judgment on second claim for relief; memorandum in support; certificate of service – set for 11:15 3/23/98 before Judge Alan C. Kay (tbf) [Entry date 01/29/98]
		* * *
7/30/98	34	NOTICE OF MOTION and motion by defendant Benjamin J. Cayetano, defendant Margery S. Bronster for summary judgment; memorandum in support of defts' motion and in opposition to pltf's motion for partial summary judgment on second claim for relief;

declaration of Keith B. Leffler; exhibit "1"; and certificate of service – FILED UNDER SEAL – set for 9:45 9/8/98 before Judge Alan C. Kay (mm)

* * *

7/30/98 37 STIPULATION of facts [25-1] [34-1] – on behalf of pltf (mm) [Entry date 07/31/98]

* * *

11/10/9847 ORDER RE: MOTIONS FOR SUMMARY JUDGMENT by Judge Alan C. Kay – [granting plaintiff's motion for summary judgment on second claim for relief [25-1]; denying defendants' motion for summary judgment [34-1]] (cc: all counsel) (wn)

12/22/9848 STIPULATION for partial dismissal without prejudice of Counts 1, 3, and 4 of the first amended complaint; ORDER – by Judge Alan C. Kay – on behalf of pltf (mm) [Entry date 12/29/98] [Edit date 01/08/99]

12/22/9849 JUDGMENT – [ordered, adjudged and decreed that: 1. pltf have jgm in its favor and against defts Cayetano and Bronster, on the 2nd claim for relief of 1st and compl, etc. 2. 1st, 3rd and 4th claims for relief are hereby dismissed; 3. Chevron shall recover its cost of suit incurred herein] -- by Judge Alan C. Kay – on behalf of pltf: terminating case (c: all counsel) (mm) [Entry date 01/08/99]

* * *

1/19/99 52 NOTICE OF APPEAL; representation statement – by defendant from Dist. Court decision, [49-2] – coa 99-15108 (cc: all counsel) (tbf) [Entry date 01/20/99] [Edit date 02/08/99]

* * *

11/15/0055 JUDGMENT – 9TH CCA vacated and remanded the Decision of the District Court [Appeal [52-1] – Judges' Nelson, Beezer, and Fletcher, Circuit Judges (cc: all counsel, Judge Alan C. Kay, mag Judge Francis I. Yamashita, CRD(s) – Dottie Miwa & Sadie Mukawa) (lg) [Entry date 11/20/00] [Edit date 11/20/00]

* * *

2/22/02 90 STIPULATION re: adoption of stipulation of facts for trial; exhibit a (byy)

2/22/02 91 DECLARATION of expert witness John Umbeck (byy) [Entry date 02/25/02]

2/25/02 92 Direct testimony by DECLARATION of expert witness Keith Leffler; exhibit 1; certificate of service – by defendant (byy) [Entry date 02/26/02]

2/26/02 93 EP: Non Jury Trial – Opening statement by the defendant.

* * *

3/25/02 99 EP: Further evidentiary hearing: plaintiff's witness: John Ombeck recalled by the court; defendant's witness: Keith Leffler recalled by the court; case is submitted (Ct Rptr: Debra Chun) JUDGE Judge Susan O. Mollway (byy)

3/29/02 100 FINDINGS of fact and conclusions of law and Order by Judge Susan O. Mollway (cc: all counsel) (byy)

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* * *

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A. INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii, MARGERY S. BRONSTER, Attorney General of the State of Hawaii, Defendants.	Civil No. 97-00933 ACK (Constitutionality of State Statute) FIRST AMENDED COMPLAINT; EXHIBIT "A"; SUMMONS

FIRST AMENDED COMPLAINT

(Filed Jul. 25, 1997)

Plaintiff CHEVRON U.S.A. INC. ("Chevron") alleges as follows:

PARTIES

1. Chevron is a Pennsylvania Corporation. Chevron builds, owns, leases, and operates service stations nationwide, including in the State of Hawaii.

2. Defendant Benjamin J. Cayetano is the Governor of the State of Hawaii (the "Governor") and is sued in that capacity. The Governor is charged by law with all executive action, including the ultimate responsibility for enforcing the laws of the State of Hawaii

3. Defendant Margery S. Bronster is the Attorney General of the State of Hawaii (the "Attorney General") and is sued in that capacity. The Attorney General is charged by law with the responsibility for enforcing the laws of the State of Hawaii.

JURISDICTION AND VENUE

4. This Court has jurisdiction over this action pursuant to 28 U.S.C. §§ 1331 and 1343. This action arises under Article 1 of the Constitution of the United States and the Fifth and Fourteenth Amendments to the Constitution of the United States. Chevron seeks declaratory relief pursuant to 28 U.S.C. §§ 2201 and 2202 and Rule 57 of the Federal Rules of Civil Procedure.

5. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1391.

SUMMARY OF CLAIMS

6. On June 21, 1997, Hawaii enacted Act 257, a true and correct copy of which is attached hereto as Exhibit A. Act 257 severely restricts rents on service stations, and

imposes an arbitrary and unconstitutional cap on the lease rents that Chevron can charge its dealers for service stations built and owned by Chevron. Chevron brings this action because Act 257, on its face, violates 42 U.S.C. § 1983, constitutes an unlawful taking and violates Chevron's rights to due process and equal protection under the United States Constitution. Chevron seeks a declaration that the lease rent cap provisions contained in Act 257 are unconstitutional and unenforceable, and an injunction prohibiting the Governor and Attorney General from applying or enforcing those provisions against Chevron.

FACTS COMMON TO ALL CLAIMS

7. On or about January 23, 1997, H.B. 1451, entitled "A Bill for an Act Relating to the Petroleum Industry," was introduced in the House of Representatives. The early versions of H.B. 1451 did not contain any provision limiting the lease rent payable on service stations. H.B. 1451 originated in the House of Representatives, crossed over to the Senate, and became final in the Conference Committee. H.B. 1451 was signed into law by the Governor on June 21, 1997, as Act 257.

8. Chevron is informed and believes that, after the Senate hearing on H.B. 1451 had already been held, a proposed Senate Draft 1 was circulated to Chevron, among others. Chevron was given an opportunity to make written comments on H.B. 1451, but there was never a public hearing where Chevron had an opportunity to testify against the rent cap provisions contained in H.B. 1451.

9. Act 257 imposes an absolute cap on the lease rents that Chevron can charge its dealers, limiting that rent to 15 percent of a dealer's gross sales (other than gasoline

sales), and 15 percent of a dealer's gross profit from gasoline sales, plus a percentage increase equal to any ground rent increase. Act 257 contains no mechanism for reviewing, adjusting, or obtaining relief from the lease rent cap.

10. Chevron is informed and believes that the lease rent cap provisions contained Act 257 were specifically designed to prohibit implementation in Hawaii of Chevron's new nationwide dealer rental program that became effective in January 1997.

11. Service station dealers on the neighbor islands, who have the greatest profit margins, will benefit from the lease rent cap provisions contained in Act 257; dealers on Oahu will not benefit from those provisions and may be subject to having increased rents, which otherwise would have been reduced under Chevron's new rental program.

12. Chevron has been in business in Hawaii for over 100 years and has made substantial long-term investments in Hawaii and in Chevron's dealer distribution network.

13. Unlike some of its competitors, Chevron's distribution system in Hawaii is almost entirely dependent on its independent lessee-dealers to distribute its products. Chevron leases 64 service stations to dealers in Hawaii.

14. Under its lessee-dealer arrangement, Chevron purchases land or leases it from a third party. Chevron then makes the entire investment to build the service station and the related facilities on each location. Chevron has invested in excess of $55 million in its lessee-dealer service stations and related facilities in Hawaii. Chevron then leases the land and facilities to the dealer on a turn-key

basis. Chevron pays all taxes, maintenance and insurance, takes care of the underground tanks, and bears the risk of liability for fuel leaks and soil contamination. Chevron charges a monthly lease rent and the dealer markets Chevron products. The average investment by a dealer is minimal.

15. The term of the lease with a dealer is typically three years, although a dealer is given rights to renewal by the federal Petroleum Marketing Practices Act (15 U.S.C. § 2801 et seq.).

16. Because rents are an element of competition between oil companies, service station rents have historically been extremely low compared with other commercial real estate and compared with Chevron's expenses.

17. Under Chevron's dealer rental program in effect from 1984 through the end of 1996, Chevron determined dealer rents by estimating the gasoline volume the service station should do at competitive prices and applying a formula to determine a base "motor fuel facilities rent." Chevron also estimated the sales that it thought the dealer should make from the automotive repair facility or convenience store on the location and assessed a monthly rent of 10 percent of that estimate. The motor fuel facilities rent was subject to reduction because Chevron rebated five cents of that rent for each gallon of gasoline purchased by the dealer from Chevron in excess of a base gasoline volume set forth in the lease. The resulting rents were exceedingly low and did not cover Chevron's expenses relating to the stations, i.e., ground lease rents, real property taxes, ordinary maintenance, and depreciation. On a national basis, rents collected from dealers in 1995 covered only 56 percent of Chevron's occupancy costs.

18. The high cost of doing business Hawaii has made and continues to make the recovery of Chevron's expenses particularly difficult in Hawaii.

19. Over time, Chevron's former rental program tended to favor high margin neighbor island dealers over low margin Oahu dealers. The neighbor island dealers have less competition and are therefore able to charge higher retail or "street" prices, which result in higher profit margins for those dealers. The disparity in gross profit per gallon of gasoline between dealers on Oahu and the neighbor islands can reach as much as three times.

20. Effective January 1, 1997, Chevron implemented a new nationwide dealer rental program that restructured the manner in which Chevron calculated lease rates. The new program should allow Chevron to recover a larger percentage of its occupancy costs and, at the same time, keep rents competitive.

21. Under Chevron's new rental program, a dealer's rent is based on the dealer's actual sales and margins. As a result, the rent the dealer pays for the station will be more closely related to the value of that station to the dealer. Dealers whose stations produce greater revenues will pay larger rents and dealers with the lowest revenues will see their rents decline under the new program.

22. The motor fuel facilities rent under Chevron's new program is a percentage of the dealer's gross margin (total motor fuel volume multiplied by weighted average per gallon margin). There are three different percentage brackets applied on an incremental basis to the monthly gross margin on fuel. The rent is 18 percent on the portion up to $18,000; 32 percent on the portion between $18,000 and $28,000; and 38 percent on the portion over $28,000.

If the new rent results in an increase in the dealer's motor fuel facilities rent, only one-third of that increase would be payable during 1997, and only two-thirds would be payable during 1998. Automotive service bay rents are frozen at their prior level. For convenience stores and car washes, the rent is a sliding percentage of the dealer's monthly sales. The rent is 5 percent on the portion up to $5,000; 7 percent on the portion between $5,000 and $10,000; and 10 percent on the portion over $10,000.

23. Under Chevron's new rental program, a significant portion of Chevron dealers nationwide should see their motor fuel facilities rents decline.

24. Even with the rent increases under Chevron's new rental program, Chevron will not be recovering all of its expenses. When the new program has been fully implemented in the year 2000, Chevron estimates that it will be recovering only 75 percent of its occupancy costs nationwide, as opposed to the 56 percent it recovered in 1995.

25. During the month of April 1997, Chevron received a total of $338,832 in lease rent from its dealers in Hawaii. For that same month, Chevron's expenses relating to the stations, i.e., ground lease rents, real property taxes, ordinary maintenance, and depreciation, totaled $548,065 exceeding Chevron's rental income by $209,233. Chevron was able to recover amounts that were above its expenses on only 12 of the 64 stations it leases to dealers in Hawaii.

26. Under Chevron's new rental program, the projected lease rents for 22 Chevron dealers in Hawaii, based on April 1997 sales, would stay the same or be

decreased by as much as $2,900 per month. Twenty-four Chevron dealers in Hawaii would have their rents increased by a range of $36 per month to $1,183 per month. The remaining 18 Chevron dealers Hawaii would have their rents increased by a range of $1,459 per month to $12,930 per month. Of those 18 dealers, all but 2 are located on the neighbor islands where the dealers' profit margins are as much as three times those of Oahu dealers.

27. Under Chevron's new rental program, when fully implemented in the year 2000, Chevron's projected monthly lease rents in Hawaii, based on April 1997 sales, would increase, but would still fall approximately 11 percent short of Chevron's April 1997 expenses.

28. Many of Chevron's stations are over 30 years old and will require substantial capital improvements in order to remain competitive. The cost of renovating a station or tearing down the existing facilities and building a new station ranges from $800,000 to over $2,000,000.

29. Act 257 will prevent Chevron from implementing its new nationwide service station rental program in Hawaii.

30. The lease rent cap imposed by Act 257 prevents Chevron from charging rent sufficient to allow it to recover its expenses relating to its dealer operated stations and precludes any chance of earning any return on Chevron's significant investment in service stations leased to dealers in Hawaii.

31. The lease rent cap imposed by Act 257 primarily benefits a small group of neighbor island dealers who currently enjoy profit margins which are as much as three times more than the margins achieved by Chevron's Oahu

dealers. Under the cap, the most profitable dealers will receive a rent decrease and the Oahu dealers, with lower profit margins, may be subject to having increased rent, which otherwise would have been reduced under Chevron's new rental program.

32. Act 257 favors oil companies who elected not to invest in a dealer distribution network, but instead built company-operated stations. Those companies entered the market long after Chevron did and continue to expand at Chevron's expense. Act 257 gives those companies an unfair advantage in that they do not have many retail dealers and thus will not be forced to subsidize many dealer operations with below-market rents.

33. An actual controversy has arisen and now exists between plaintiff and defendants relative to their respective rights and duties herein alleged.

34. Defendants contend that plaintiff's rights have not been violated and that the lease rent cap provisions of Act 257 are enforceable and constitutional.

35. Plaintiff contends that its rights have been violated and that Act 257 the lease rent cap provisions of Act 257 are unenforceable and unconstitutional.

36. Plaintiff desires a declaration of its rights pursuant to Rule 57 of the Federal Rules of Civil Procedure, and 28 U.S.C. §§ 2201 and 2202. Such declaration is necessary and appropriate at this time because plaintiff has been irreparably injured and will continue to suffer irreparable injury until the lease rent cap provisions of Act 257 are declared to be unconstitutional and unenforceable.

37. Plaintiff will suffer immediate and irreparable injury if an injunction is not issued prohibiting defendants

from enforcing the lease rent cap provisions of Act 257. Plaintiff has no adequate remedy at law because, among other things, plaintiff could only secure legal relief through a multiplicity of separate lawsuits, filed each and every time one of the leases for one of the Chevron dealers in Hawaii comes up for renewal after the effective date of Act 257; the lease for rent cap provisions contained in Act 257 fail to authorize the State of Hawaii to relieve Chevron from the losses it will suffer; leases renewed after the effective date of Act 257 will result in an irretrievable loss to Chevron and an unwarranted benefit to certain dealers who renew their leases after that date.

FIRST CLAIM FOR RELIEF

(Deprivation of Constitutional Rights in Violation of 42 U.S.C. § 1983)

38. Plaintiff incorporates by reference each and every allegation contained in paragraphs 1 through 37 as though fully set forth herein.

39. As a direct result of defendants' actions, official policy, and course of conduct, defendants, under color of law, have deprived Chevron of rights, privileges and immunities secured by the United States Constitution in violation of 42 U.S.C. § 1983, as herein alleged.

SECOND CLAIM FOR RELIEF

(Unlawful Taking in Violation of the Fifth and Fourteenth Amendments of the United States Constitution)

40. Plaintiff incorporates by reference each and every allegation contained in paragraphs 1 through 37 and paragraph 39 as though fully set forth herein.

41. Act 257, on its face, effects an impermissible taking of Chevron's property in violation of the Fifth and Fourteenth Amendments of the United States Constitution.

42. Chevron is entitled to a just and reasonable rate of return on its investment. Act 257 systematically guarantees that Chevron will receive no return on its investment by freezing rents at a level that is lower than Chevron's expenses, resulting in a rent cap that is necessarily confiscatory.

43. The enactment of Act 257 denies Chevron the economically viable use of its property and does not substantially advance any legitimate state interest.

44. The rent cap imposed by Act 257 is arbitrary.

45. Act 257 indiscriminately and uniformly places a cap on the lease rent that Chevron may charge to its dealers in Hawaii.

46. Act 257 contains no mechanism for reviewing, adjusting, or obtaining relief from the lease rent cap to prevent confiscatory results.

47. In determining the maximum allowable rent, Act 257 contains no mechanism providing for any individualized consideration of any particular piece of property. Nothing in Act 257 allows for consideration of numerous unique factors, including the characteristics or market value of each piece of property, the risk associated with the asset, land values over time, the rate of development of surrounding areas, margins, or any other factors which may have an impact on the value of a particular lease or service station. Act 257 does not differentiate among dealers and does not allow for consideration of any unique

factors, including the profitability of a particular station to a particular dealer or the ability of a particular dealer to pay rent to Chevron.

48. Act 257 does not preclude the sale or conveyance of leases by service station dealers and specifically provides that "[n]othing in this section shall prohibit a dealer from selling a retail service station in any manner." The Federal Petroleum Marketing Practices Act essentially grants lessee-dealers tenure for the duration of the lessor's control over the underlying property. Thus, so long as Chevron chooses to be in business at the location leased to the dealer, the dealer is entitled to continue to operate the service station, absent certain limited grounds for termination. Dealers also have the right to assign their occupancy rights, and a thriving market exists for those rights. The right to be a Chevron dealer at a particular location (where the investment is entirely Chevron's) often changes hands in the marketplace for several hundred thousand dollars. The existing dealer at the time of the enactment of Act 257 is able to transfer its interest in the service station at a premium because of the low rent cap mandated by Act 257. The availability of the premium and the resulting transfer of wealth and value from Chevron to the dealer fails to advance any purported legislative purpose for which Act 257 was enacted, and results in an unlawful taking.

49. The lease rent cap provisions contained in Act 257 are not reasonably necessary to the effectuation of any substantial governmental purpose. There is no nexus between any purported legislative purpose of Act 257 and the means used to further any such purpose. There is no proportionality between the burdens imposed on Chevron

by Act 257 and the benefits accruing to service station dealers in Hawaii as a whole.

THIRD CLAIM FOR RELIEF

(Violation of Due Process Rights Under the Fifth and Fourteenth Amendments of the United States Constitution)

50. Plaintiff incorporates by reference each and every allegation contained in paragraphs 1 through 37, 39, and 41 through 49 as though fully set forth herein.

51. Act 257 violates Chevron's substantive due process rights under the Fifth and Fourteenth Amendments of the United States Constitution.

52. The lease rent cap provisions contained in Act 257 are arbitrary, discriminatory, capricious, unreasonable and irrelevant to any legitimate exercise of Hawaii's police powers.

53. Act 257 deprives Chevron of a fair and reasonable return on its investment. Among its other deficiencies, Act 257 denies Chevron any rent increases on account of capital improvements made prior to the enactment of Act 257 and limits the amount Chevron may recover on account of any improvements that may be made after the enactment of that statute.

FOURTH CLAIM FOR RELIEF

(Violation of Equal Protection Rights Under the Fourteenth Amendment of the United States Constitution)

54. Plaintiff incorporates by reference each and every allegation contained in paragraphs 1 through 37, 39, 41 through 49, and 51 through 53 as though fully set forth herein.

55. Act 257 violates Chevron's equal protection rights under the Fourteenth Amendment of the United Stats Constitution.

56. On its face, Act 257 unreasonably and arbitrarily reclassifies oil companies, who are subject to the lease rent cap provisions of Act 257, and other lessors and landowners who are not.

57. The lease rent cap provisions of Act 257 unreasonably and arbitrarily discriminate against companies, such as Chevron, that are heavily dependent on a dealer distribution network.

58. The classification scheme embodied in Act 257 is not rationally related to any legitimate state interest. The varying treatment of different groups is unrelated to the achievement of any legitimate purpose.

59. The enactment of Act 257 was prompted by and reflects impermissible animus and hostility toward a particular group.

WHEREFORE, Chevron prays for relief as follows:

(1) as to the First Claim for Relief, a declaration that (a) Act 257 deprives Chevron of its constitutional

rights in violation of 42 U.S.C. § 1983; and (b) the lease rent cap provisions contained in Act 257 may not be applied or enforced against Chevron;

(2) as to the Second Claim for Relief, a declaration that (a) Act 257, on its face, effects an impermissible taking of Chevron's property in violation of the Fifth and Fourteenth Amendments of the United States Constitution; and 9b) the lease rent cap provisions contained in Act 257 may not be applied or enforced against Chevron;

(3) as to the Third Claim for Relief, a declaration that (a) Act 257 violates Chevron's substantive due process rights under the Fifth and Fourteenth Amendments of the United States Constitution; and (b) the lease rent cap provisions contained in Act 257 may not be applied or enforced against Chevron;

(4) as to the Fourth Claim for Relief, a declaration that (a) Act 257 violates Chevron's equal protection rights under the Fourteenth Amendment of the United States Constitution; and (b) the lease rent cap provisions contained in Act 257 may not be applied or enforced against Chevron;

(5) as to all Claims for Relief, an injunction prohibiting defendants from applying or enforcing the lease rent cap provisions contained in Act 257 against Chevron;

(6) an award of attorneys' fees and costs; and

(7) an award of such other and further relief as the Court may deem just and proper.

DATED: Honolulu, Hawaii, 7/24/97.

/s/ John R. Myrdal
JOHN R. MYRDAL
JEFFREY A. DAMASIEWICZ

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BRUCE C. BIGELOW

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[Exhibit "A" (Act 257) and Summons not reprinted in this Appendix.]

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A. INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii, MARGERY S. BRONSTER, Attorney General of the State of Hawaii, Defendants.	) CIVIL NO. 97-00933 ACK (Constitutionality of State Statute) DEFENDANTS BENJAMIN J. CAYETANO AND MARGERY S. BRONSTER'S ANSWER TO THE COMPLAINT FILED ON 7/21/97 AND AMENDED ON 7/25/97; CERTIFICATE OF SERVICE

DEFENDANTS BENJAMIN J. CAYETANO AND MARGERY S. BRONSTER'S ANSWER TO THE COMPLAINT FILED ON 7/21/97 AND AMENDED ON 7/25/97

(Filed Sep. 8, 1997)

Defendants BENJAMIN J. CAYETANO, Governor of the State of Hawaii, and MARGERY S. BRONSTER,

Attorney General of Hawaii, by its undersigned attorneys, answer the First Amennded Complaint as follows:

1. Defendants admit the allegations of paragraph 1.

2. Defendants admit the allegations of paragraph 2.

3. Defendants admit the allegations of paragraph 3.

4. Defendants deny the allegations of paragraph 4.

5. Defendants admit the allegations of paragraph 5.

6. Defendants admit the first and last sentences in paragraph 6. Defendants deny the other allegations of paragraph 6.

7. Defendants admit the allegations of paragraph 7.

8. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 8.

9. Defendants deny the allegations in paragraph 9.

10. Defendants are without knowledge or information sufficient to form a belief as to the truth of Chevron's allegations in paragraph 10 of what it is informed or what it believes. Defendants deny the other allegations of paragraph 10.

11. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 11.

12. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 12.

13. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 13.

14. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 14.

15. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 15, except that the federal Petroleum Marketing Practices Act and the cases applying it speak for themselves.

16. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 16.

17. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 17.

18. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 18.

19. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 19.

20. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 20.

21. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 21.

22. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 22.

23. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 23.

24. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 24.

25. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 25.

26. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 26.

27. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 27.

28. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 28.

29. Defendants deny the allegations in paragraph 29.

30. Defendants deny the allegations in paragraph 30.

31. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 31.

32. Defendants deny the allegations of paragraph 32.

33. Defendants deny the allegations of paragraph 33.

34. As to paragraph 34, Defendants deny that they have made any contentions herein except as set out in this answer, including all affirmative defenses.

35. Defendants deny Plaintiff's contentions in paragraph 35.

36. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 36 of Plaintiff's desires. Defendants deny the other allegations of paragraph 36.

37. Defendants deny the allegations in paragraph 37.

38. With respect to paragraph 38, Defendants incorporate its answers to paragraphs 1 through 37.

39. Defendants deny the allegations of paragraph 39.

40. With respect to paragraph 40, Defendants incorporate its answers to paragraphs 1 through 37 and 39.

41. Defendants deny the allegations of paragraph 41.

42. Defendants deny the allegations of paragraph 42.

43. Defendants deny the allegations of paragraph 43.

44. Defendants deny the allegations of paragraph 44.

45. Defendants deny the allegations of paragraph 45.

46. Defendants deny the allegations of paragraph 46.

47. As to Plaintiff's allegations of the effect of Act 257, Act 257 speaks for itself. Defendants deny the other allegations of paragraph 47.

48. As to Plaintiff's allegations of the meaning and effect of Act 257 and the federal Petroleum Marketing Practices Act, the acts speak for themselves. Defendants deny the other allegations of paragraph 48 except that the Defendants are without knowledge or information sufficient to form a belief as to the truth of the fifth and sixth sentences of paragraph 48.

49. Defendants deny the allegations of paragraph 49.

50. As to paragraph 50, Defendants incorporate their answers to paragraphs 1-37, 39, and 41-49.

51. Defendants deny the allegations of paragraph 51.

52. Defendants deny the allegations of paragraph 52.

53. Defendants deny the allegations of paragraph 53.

54. As to paragraph 54, Defendants incorporate their answers to paragraphs 1-37, 39, 41-49, and 51-53.

55. Defendants deny the allegations of paragraph 55.

56. Defendants deny the allegations of paragraph 56.

57. Defendants deny the allegations of paragraph 57.

58. Defendants deny the allegations of paragraph 58.

59. Defendants deny the allegations of paragraph 59.

First affirmative defense: Plaintiff fails to state a claim on which relief can be granted.

Second affirmative defense: Plaintiff's claims are barred by the Eleventh Amendment.

Third affirmative defense: The court does not have subject matter jurisdiction because there is no case or controversy.

Fourth affirmative defense: The court does not have subject matter jurisdiction because the Plaintiff has adequate remedies at law.

Fifth affirmative defense: Plaintiff has failed to join indispensable parties.

Sixth affirmative defense: The court is obligated to abstain under the rule of *Railroad Commission of Texas v. Pullman*, 312 U.S. 496 (1941).

Seventh affirmative defense: Plaintiff does not have standing.

Eighth affirmative defense: Plaintiff's claims are barred by superseding cause.

Ninth affirmative defense: Plaintiff's claims are not ripe.

Tenth affirmative defense: The court should certify questions about the application of Act 257 to the Supreme Court of Hawaii.

Eleventh affirmative defense: Plaintiff's claims are barred by Plaintiff's unclean hands.

WHEREFORE, Defendants pray

A. That Plaintiff's requests for relief be denied and that the complaint be dismissed with prejudice.

B. That Defendants be awarded their attorneys fees and costs.

C. That Defendants be awarded such other relief as is just and proper.

DATED: Honolulu, Hawaii, September 8, 1997.

STATE OF HAWAII

/s/ [Illegible]
TED GAMBLE CLAUSE
Deputy Attorney General

/s/ Deborah Day Emerson
DEBORAH DAY EMERSON
Deputy Attorney General

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[Certificate Of Service Omitted In Printing]

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A. INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; MARGERY S. BRONSTER, Attorney General of the State of Hawaii, Defendants.	) Civil No. 97-00933 ACK) (Constitutionality of State Statute))) JUDGMENT)) (Filed Dec. 22, 1998)

JUDGMENT

On consideration of the opinion of this court made and entered in this cause on November 10, 1998, and for the reasons stated herein,

It is hereby *ORDERED, ADJUDGED* AND *DECREED* that:

1. Plaintiff Chevron U.S.A. Inc. have judgment in its favor and against defendants Benjamin J. Cayetano, Governor of the State of Hawaii and Margery S. Bronster, Attorney General of the State of Hawaii, on the Second Claim for Relief of the first amended complaint. The Court declares that (a) Section 3(c)(2) of Act 257, on its face, effects an impermissible taking of Chevron's property in violation of the Fifth and Fourteenth Amendments of the United States Constitution; and (b) defendant Bronster in her capacity as Attorney General of the State of Hawaii and all others authorized by law to enforce section 3(c)(2) of Act 257, and all those acting as agents or employees of the State of Hawaii be, and each is hereby, enjoined from applying or enforcing section 3(c)(2) of Act 257 against Chevron.

2. Chevron having agreed to proceed on the second claim for relief of the first amended complaint and not to pursue relief under any other claim alleged therein, the first, third and fourth claims for relief are hereby dismissed.

3. Chevron shall recover its cost of suit incurred herein.

Dated: Honolulu, Hawaii, Dec. 22, 1998.

/s/ Alan C. Kay
Alan C. Kay
United States District Judge

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A., INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI, Attorney General of the State of Hawaii, Defendants.	CIVIL NO. 97-00933 SOM (Constitutionality of State Statute) **STIPULATION RE: ADOPTION OF STIPULATION OF FACTS FOR TRIAL; EXHIBIT A** (Filed Feb. 22, 2002) Trial Date: February 26, 2002 Time: 9:00 a.m.

STIPULATION RE: ADOPTION OF STIPULATION OF FACTS FOR TRIAL

Plaintiff CHEVRON U.S.A. and Defendants BENJAMIN J. CAYETANO, Governor of the State of Hawaii, and EARL I. ANZAI, Attorney General of the State of Hawaii, by and through their attorneys of record, hereby stipulate that the Stipulation of Facts attached hereto as Exhibit A is adopted for purposes of trial.

DATED: 2/20/02 /s/ Tred R. Eyerly
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Attorneys for Plaintiff

DATED: 2/20/02 /s/ Charles H. Price
JAMES E.T. KOSHIBA
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Exhibit A

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A. INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; MARGERY S. BRONSTER, Attorney General of the State of Hawaii, Defendants.	Civil No. 97-00933 ACK (Constitutionality of State Statute) STIPULATION OF FACTS (Filed Jul. 30, 1998) Trial Date: February 2, 1999

STIPULATION OF FACTS

Preamble

Plaintiff, Chevron U.S.A. Inc. ("Chevron"), and defendants, Benjamin J. Cayetano and Margery S. Bronster in their representative capacities as Governor and Attorney General of the State of Hawaii respectively ("defendants"), by and through their attorneys of record, hereby submit the following Stipulation of Facts in connection with Chevron's Motion for Partial Summary Judgment on Second Claim for Relief and Defendants' Motion for Summary Judgment. The sole purpose of this Stipulation of Facts is to deem each of the following statements, whether considered a factual statement, a legal conclusion, or a combination of both, to be undisputed as between the parties. In entering into this stipulation, the parties: 1) reserve the right to object to the relevance of any of the following statements; 2) reserve the right to claim that other statements, which may remain disputed, are relevant to the pending motions for summary judgment, but agree to limit any such statements to those which may be submitted by the parties' respective expert witnesses; and 3) reserve the right to object on any grounds to any or all additional statements submitted by the other party.

Proposed Stipulation of Facts

1. On June 21, 1997, the State of Hawaii enacted Act 257.

2. Effective January 1, 1997, Chevron implemented a new nationwide dealer rental program that restructured the manner in which Chevron calculates rents paid under service station leases.

3. The lease rent cap provisions contained in Act 257 prohibit complete implementation in Hawaii of the rent rates specified in Chevron's new dealer rental program.

4. Under Chevron's rental program (as it would have operated in Hawaii absent Act 257) the "motor fuel facilities rent" is a percentage of the dealer's gross margin on motor fuel sales (total motor fuel sales volume multiplied by weighted average per gallon margin). There are three different percentage brackets applied on an incremental basis to the monthly gross margin on fuel. The rent is 18 percent on the portion up to $18,000; 32 percent on the portion between $18,000 and $28,000; and 38 percent on the portion over $28,000. Act 257 does not allow Chevron to charge the "motor fuel facilities" rent that it otherwise would have charged. Act 257 does not have a direct impact on non-motor fuel facilities rent under Chevron's rental program because the 15 percent cap is greater than what Chevron would have otherwise charged as non-motor fuel facilities rent without Act 257.

5. Pending the outcome of this litigation, Chevron amended all new dealer leases in Hawaii. For leases signed after June 20, 1997, rents (starting with September 1997) have been and will be established at the maximum amount permitted by Act 257. If the rent under Act 257 (counting both motor fuel facilities rent and non-motor fuel facilities rent) exceeds the rent which would have been charged under Chevron's new rental program by more than $500 in any particular month, Chevron will waive the difference for that month. Thus, no dealer will be required to pay more than $500 more in any month than the dealer would have been required to pay under Chevron's new rental program. The $500 maximum sum is intended as an administrative fee to help defer Chevron's

additional cost of administering a new and different rental program for Hawaii, particularly the cost of monitoring automotive service bay sales. If Act 257 is held to be invalid, the lessee-dealer will be required to pay Chevron the difference between the amount that otherwise would have been paid under Chevron's new rental program and any lesser amount actually paid by the dealer under Act 257. These facts are reflected in Table 1, attached hereto.

6. Chevron estimates that, after all lessee dealer agreements in Hawaii are renewed under Act 257, the Act will preclude Chevron from charging the rent it otherwise would have charged for 11 of Chevron's 64 lessee dealer stations in Hawaii. These facts are reflected in Table 1, attached hereto. In addition, the rental provisions of Act 257 cause Chevron to require dealers to account for automotive service bay sales which it otherwise would not do and to lower the motor fuel facilities rents for all lessee dealers in Hawaii.

7. Under its lessee-dealer arrangement, Chevron purchases land or leases it from a third party, makes the entire investment to build the service station and to build the related facilities on each location, and leases the land and facilities to the dealer on a turn-key basis.

8. Chevron incurs ongoing expenses attributable to the lessee-dealer rental property, such as ground lease rents, real property taxes, ordinary maintenance (subject to the terms and conditions of the dealer lease), and the accounting expense entry of "depreciation."

9. Under a dealer lease, Chevron charges the lessee-dealer a monthly lease rent. Under a supply contract, the lessee-dealer markets Chevron motor fuels, which the

determined by Chevron. Chevron does not enter into a dealer lease unless the dealer simultaneously executes a supply contract with Chevron. Copies of the lease and supply contract Chevron would use under the new program are attached.

10. Chevron has invested more than $58,000,000 in its current lessee-dealer service stations and related facilities in Hawaii. The present book value of those same service stations and related facilities is more than $37,000,000.

11. Table 1 is an accurate summary of the projected rents for each Chevron lessee-dealer station in Hawaii for the twelve month period from January 1, 1998 through December 31, 1998.

12. The maximum rents Chevron projects it could receive under the statutory scheme imposed by Act 257, when applied to all Chevron dealer leases in Hawaii, total $6,126,646 during the 12-month period from January 1, 1998 through December 31, 1998.

13. Chevron's projected expenses during the 12-month period from January 1, 1998 to December 31, 1998 for its lessee-dealer stations in Hawaii, i.e., ground lease rents, real property taxes, ordinary maintenance, depreciation, and other direct station expenses total $6,292,855, exceeding Chevron's projected rental income by $166,209.

14. Chevron would not invest in lessee-dealer stations except for its expectation that Chevron gasoline will be sold at such stations.

15. Chevron requires each lessee-dealer to market Chevron-branded gasoline purchased directly from Chevron

as a condition of Chevron's entering a lease with the dealer.

16. Although any dealer who installs his own pumps and tanks is legally free to purchase non-Chevron gasoline, each Chevron lessee dealer in Hawaii currently obtains (and has obtained for at least the last 10 years) its supply of gasoline exclusively from Chevron.

17. Chevron recovers its expenses and investment costs of lessee dealer stations (e.g., ground-lease rent, real property taxes, ordinary maintenance, and depreciation) in Hawaii and throughout the United States through two principal revenue streams – rental revenue and earnings on Chevron gasoline sold through the stations.

18. Chevron's evaluation of the return on investment from the development of new lessee-dealer stations in Hawaii and throughout the United States includes in the return a measure of the expected earnings from the sale of Chevron-branded gasoline at the station.

19. Chevron has provided incentive payments to dealers that own their stations in return for the dealer's agreement to market Chevron-branded gasoline. These incentives typically take one of three forms: (a) a discount off the normal lessee-dealer gasoline price, (b) an upfront cash advance typically used for improvements to the station, which is amortized on a cents per gallon basis over a fixed period (usually 10 years), or (c) a combination of (a) and (b). Since 1990, the size of such upfront payments (under (b) above) in Hawaii have been as follows:

$ 18,000
$ 20,000
$110,000
$110,000

$248,654.12
$300,000
$400,000

The first two listed were funds for branding only (i.e., signs, painting, etc.).

20. It is economically rational for Chevron to provide such incentives because Chevron expects to recover the incentive payments via earnings from sales of Chevron-branded gasoline.

21. Including Chevron's earnings from gasoline sold by Chevron at its lessee dealer stations in Hawaii, Chevron has earned in the past and anticipates that it will earn in the future, at the rent levels allowed by Act 257, a return that satisfies any Constitutional standards on its investment in lessee dealer stations in Hawaii.

22. Chevron has positive net earnings from its sales of gasoline to Hawaii resellers.

23. In the aggregate, Chevron has not within the last 20 years recovered its expenses relating to dealer stations (ground lease rents, real property taxes, ordinary maintenance, and depreciation) in Hawaii or elsewhere in the United States from dealer station rents.

24. Chevron's dealer leases run for a three-year term, unless Chevron's underlying ground lease expires in less than three years, in which case the dealer lease expires at the same time as the underlying ground lease.

25. So long as Chevron chooses to be in business at the location leased to the dealer, the dealer is entitled, under the federal Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-2806, to continue to operate the service

station, absent certain limited grounds for termination and nonrenewal set forth in the Act. Under 15 U.S.C. § 2802(b)(3)(A), Chevron can make changes in the dealer lease (including the rent) and supply contract at the time of each 3-year renewal as long as those changes are proposed "in good faith and in the normal course of business" and not "for the purpose of converting the leased marketing premises to operation by employees or agents of the franchisor for the benefit of the franchisor or otherwise preventing renewal of the franchise relationship."

26. Chevron's lessee-dealer lease and supply contracts permit the lessees to assign their occupancy rights, subject to obtaining Chevron's written consent and paying a transfer fee set by Chevron before assigning a lease or any interest therein.

27. Neither Chevron's dealer lease nor Chevron's dealer supply contract limits the price at which a lessee dealer can sell, convey, or otherwise transfer his or her occupancy rights.

28. Act 257 allows the sale, conveyance or other transfer of leases by service station dealers.

29. Act 257 does not limit the price at which a lessee dealer can sell, convey or otherwise transfer his or her interest in a service station lease.

30. Act 257 does not prohibit Chevron from refusing to consent to a transfer of a dealer station by a dealer lessee so long as Chevron acts in good faith as defined in HRS § 486H-1.

31. Act 257 does not prohibit Chevron from requiring any amendment of its dealer leases at the time of each

3-year renewal except with respect to the amount of rent Chevron can charge the dealer-lessee, so long as Chevron acts in good faith as defined in HRS § 486H-1.

32. Since 1992, each of the following Chevron lessee dealers sold his or her interest in the gasoline station ("lessee dealer station") to another individual:

Station	Date of Sale	Transfer Price	Average Monthly Gallons Prior Year	Estimated Monthly APC Sales
91970	Oct. 94	$250,000	74,841	$40,000
93053	Mar. 95	$100,000	94,078	$45,000
93053	Dec. 93	$100,000	87,683	$40,000
93183	Jun. 93	$95,000	96,517	$20,000
93215	Sep. 95	$80,000	131,015	$25,000
95318	Jan. 93	$180,000	124,801	$22,000
97303	Jan. 94	$140,000	148,617	$35,000
98132	Jan. 92	$500,000	172,235	$50,000
98242	Aug. 97	$200,000	261,463	$55,000
98691	Nov. 93	$348,000	163,565	$20,000
99070	Aug. 94	$90,000	103,619	$22,000
99080	Jan. 92	$165,000	48,121[1]	$15,000
99425	Oct. 94	$360,000	123,834	$20,000
99723	Apr. 94	$400,000	196,897	$40,000

[1] 1991 volume data is not available. This figure represents the average monthly sales for the 1990 calendar year.

33. According to the information reasonably available to Chevron, since 1992, 14 Chevron lessee dealers in Hawaii have assigned their leases and supply agreements to third persons. Chevron expects that further assignments will occur in the future.

34. The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act 257, assuming Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment.

35. Assuming everything else remains equal, the market value of the lessee-dealer leasehold reasonably could be expected to increase as the amount of the rent payable decreases.

36. The earnings available to the Chevron lessee dealer from the sale of gasoline at a particular Chevron lessee dealer station in Hawaii depend upon a number of factors including the dealer's expertise and business acumen, the location of the station, the features of the station, the location of competitors' stations, the pricing at competitors' stations, the rent paid by the lessee dealer, other costs of the station, and the price paid by the dealer to Chevron for gasoline.

37. The competitive conditions facing retail gasoline station dealers vary from dealer to dealer.

38. The market shares for gasoline produced or refined in Hawaii during 1997 were approximately: Chevron 60% and BHP 40%.

39. The market shares by brand to retail outlets for the period ending May 30, 1997 were approximately:

	Chevron	Shell	Texaco	Tosco	BHP	Other
Oahu	30.7%	12.9%	12.5%	15.8%	14.4%	13.6%
Hawaii	29.5%	10.8%	11.4%	21.4%	8.0%	18.9%
Maui	20.7%	23.8%	19.0%	17.8%	11.2%	7.5%
Kauai	28.3%	43.0%	N/A	10.5%	N/A	18.2%

40. Act 257 does not apply to any dealer lease in effect on August 1, 1997.

41. Chevron has not sought compensation in the Hawaii state courts for inverse condemnation relating to Act 257.

Dated: Honolulu, Hawaii _____.

/s/ John R. Myrdal
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Attorneys for Defendants

[Exhibits Other Than Table 1 Omitted]

Chevron Products Company
Hawaii 3-Party - Annual Projections

Table 1

Station	Island	Estimated Annual Expenses	Estimated Sales			Estimated Annual Rent - under Act 257	Estimated Annual Rent - under Chevron's new rent program	Estimated Annual Rent - Revised Hawaii Program	
			Fuel Volume (Gal/Month)	Fuel Margin (cpg)	Non-Fuel Sales ($/Month)			Basis	
90258	Oahu	99,994	69,620	7.9	43,000	87,297	42,294	48,294	Chevron + $500/mo.
90371	Oahu	70,765	88,811	7.9	42,000	88,225	61,999	67,999	Chevron + $500/mo.
90464	Oahu	110,132	93,280	7.9	45,000	94,260	38,703	44,703	Chevron + $500/mo.
90903	Maui	78,873	132,423	23.1	35,000	118,136	122,855	118,136	Act 257
91053	Oahu	129,853	226,601	7.9	35,000	95,212	72,918	78,918	Chevron + $500/mo.
91217	Hawaii	39,368	69,795	27.6	30,000	88,615	59,997	65,997	Chevron + $500/mo.
91266	Maui	136,997	113,163	23.1	80,000	191,117	158,869	164,869	Chevron + $500/mo.
91317	Hawaii	75,801	124,043	27.6	55,000	160,519	163,255	160,519	Act 257
91507	Oahu	77,843	134,554	7.9	25,000	64,127	46,409	52,409	Chevron + $500/mo.
91524	Oahu	60,367	85,875	7.9	50,000	102,208	49,636	55,636	Chevron + $500/mo.
91571	Maui	52,376	114,860	23.1	40,000	119,823	117,737	119,823	Act 257
91919	Oahu	172,954	124,080	7.9	30,000	71,638	53,158	59,158	Chevron + $500/mo.
91964	Oahu	52,190	107,810	7.9	20,000	51,326	46,993	51,326	Act 257
91970	Oahu	95,813	57,807	7.9	40,000	80,217	52,312	58,312	Chevron + $500/mo.
92619	Maui	45,167	81,971	23.1	45,000	115,130	101,882	107,882	Chevron + $500/mo.
92866	Kauai	87,832	213,326	15.5	30,000	113,555	125,835	113,555	Act 257
92890	Maui	150,287	106,230	23.1	20,000	80,230	103,491	80,230	Act 257
92896	Maui	65,777	74,838	23.1	30,000	85,160	70,022	76,022	Chevron + $500/mo.
92912	Hawaii	62,400	144,366	27.6	35,000	134,599	158,233	134,599	Act 257
93053	Oahu	148,311	88,473	7.9	40,000	84,577	57,145	63,145	Chevron + $500/mo.
93183	Oahu	67,961	124,631	7.9	20,000	53,717	38,845	44,845	Chevron + $500/mo.
93186	Oahu	94,977	87,109	7.9	40,000	84,383	56,930	62,930	Chevron + $500/mo.
93207	Oahu	154,999	169,283	7.9	60,000	132,064	98,883	99,883	Chevron + $500/mo.
93555	Oahu	89,800	66,118	7.9	25,000	54,399	44,022	50,022	Chevron + $500/mo.
93568	Oahu	141,312	111,493	7.9	60,000	123,849	84,774	90,774	Chevron + $500/mo.
93719	Oahu	48,476	66,018	7.9	30,000	63,385	44,846	50,846	Chevron + $500/mo.
93778	Oahu	92,113	66,638	7.9	15,000	36,473	32,104	36,473	Act 257
93871	Kauai	66,034	107,630	15.5	40,000	102,047	65,442	71,442	Chevron + $500/mo.
93875	Oahu	116,929	166,247	7.9	65,000	140,633	75,405	81,405	Chevron + $500/mo.

Chevron Products Company
Hawaii 3-Party - Annual Projections

Table 1

Station	Island	Estimated Annual Expenses	Estimated Sales			Estimated Annual Rent - under Act 257	Estimated Annual Rent - under Chevron's new rent program	Estimated Annual Rent - Revised Hawaii Program	
			Fuel Volume (Gal/Month)	Fuel Margin (cpg)	Non-Fuel Sales ($/Month)				Basis
93970	Oahu	205,056	278,751	7.9	40,000	111,625	91,072	97,072	Chevron + $500/mo.
94109	Oahu	78,801	55,829	7.9	25,000	52,936	44,800	50,800	Chevron + $500/mo.
94204	Oahu	116,455	129,466	7.9	50,000	108,404	67,207	73,207	Chevron + $500/mo.
94682	Maui	127,485	91,083	23.1	20,000	73,924	84,241	73,924	Act 257
94871	Oahu	206,995	214,171	7.9	100,000	210,445	148,959	154,959	Chevron + $500/mo.
94888	Oahu	109,379	102,388	7.9	5,000	23,555	19,139	23,555	Act 257
95023	Oahu	106,351	181,683	7.9	40,000	97,827	76,638	77,838	Chevron + $500/mo.
95054	Molokai	66,571	98,731	35.8	70,000	189,661	169,372	175,372	Chevron + $500/mo.
95318	Oahu	59,346	154,589	7.9	20,000	57,975	43,567	49,567	Chevron + $500/mo.
95570	Oahu	49,450	62,752	7.9	25,000	53,920	42,291	48,291	Chevron + $500/mo.
95592	Oahu	62,001	112,421	7.9	15,000	42,981	39,320	42,981	Act 257
95683	Oahu	98,516	82,697	7.9	35,000	74,756	39,435	45,435	Chevron + $500/mo.
95812	Oahu	84,536	102,383	7.9	40,000	86,554	53,338	59,338	Chevron + $500/mo.
96005	Hawaii	84,516	180,062	27.6	40,000	161,302	214,105	161,302	Act 257
96247	Oahu	53,855	108,818	7.9	40,000	87,474	78,352	84,352	Chevron + $500/mo.
96728	Oahu	137,946	87,924	7.9	45,000	93,499	43,259	49,259	Chevron + $500/mo.
96737	Oahu	70,870	42,299	7.9	10,000	24,013	43,867	24,013	Act 257
97186	Oahu	169,699	86,333	7.9	60,000	120,272	68,964	74,964	Chevron + $500/mo.
97303	Oahu	177,697	123,743	7.9	11,000	37,391	46,505	37,391	Act 257
97442	Kauai	59,929	123,322	15.5	25,000	79,428	65,565	71,565	Chevron + $500/mo.
97458	Oahu	34,757	65,231	7.9	20,000	45,273	31,882	37,882	Chevron + $500/mo.
97619	Kauai	111,051	90,805	15.5	45,000	106,350	75,983	81,983	Chevron + $500/mo.
97970	Oahu	145,826	112,302	7.9	30,000	69,964	48,901	54,901	Chevron + $500/mo.
98132	Hawaii	93,005	136,151	27.6	70,000	193,524	164,936	170,936	Chevron + $500/mo.
98242	Oahu	182,611	267,841	7.9	50,000	128,075	100,015	106,015	Chevron + $500/mo.
98584	Oahu	74,195	121,303	7.9	35,000	80,244	56,320	62,320	Chevron + $500/mo.
98673	Oahu	122,052	192,312	7.9	40,000	99,338	73,513	79,513	Chevron + $500/mo.
98691	Hawaii	148,089	166,516	27.6	40,000	149,624	185,166	149,624	Act 257
98823	Oahu	49,752	133,807	7.9	35,000	82,021	66,691	72,691	Chevron + $500/mo.

Chevron Products Company
Hawaii 3-Party - Annual Projections

Table 1

Station	Island	Estimated Annual Expenses	Estimated Sales			Estimated Annual Rent - under Act 257	Estimated Annual Rent - under Chevron's new rent program	Estimated Annual Rent - Revised Hawaii Program	
			Fuel Volume (Gal/Month)	Fuel Margin (cpg)	Non-Fuel Sales ($/Month)				Basis
99070	Oahu	37,554	101,942	7.9	30,000	68,491	40,669	46,669	Chevron + $500/mo.
99080	Oahu	119,543	163,505	7.9	30,000	77,243	56,972	62,972	Chevron + $500/mo.
99248	Oahu	52,299	78,284	7.9	35,000	74,128	47,139	53,139	Chevron + $500/mo.
99425	Oahu	203,296	139,261	7.9	25,000	64,796	41,751	47,751	Chevron + $500/mo.
99691	Hawaii	67,557	70,003	27.6	40,000	106,718	85,089	91,089	Chevron + $500/mo.
99723	Hawaii	50,113	155,245	27.6	55,000	175,994	189,604	175,994	Act 257
Total		6,292,855	7,621,044			6,126,646	4,989,521	5,078,716	

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CHEVRON U.S.A., INC.

IN THE UNITED STAKES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A., INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii, et al. Defendants.	No. 97-00933 SOM DECLARATION OF EXPERT WITNESS JOHN UMBECK Trial Date: February 26, 2002 Judge: Hon. Susan Mollway (Filed Feb. 22, 2002)

I, John R. Umbeck, declare under penalty of perjury under the laws of the State of Hawaii that my direct

testimony is attached to this declaration. It is true and correct to the best of my knowledge.

Executed in West Lafayette, Indiana on February 21, 2002.

/s/ John Umbeck
John Umbeck

DIRECT TESTIMONY OF JOHN R. UMBECK

QUALIFICATIONS

1. I am Professor of Economics in the Krannert Graduate School of Management at Purdue University. I received a Bachelor of Arts in economics from Occidental College in 1967, a Master of Arts in economics from UCLA in 1968 and a Ph.D. in economics from the University of Washington in 1976. I have been teaching economics since 1968. From 1975 on, I have been teaching at Purdue University, where I was promoted to Full Professor in 1988. I have received several awards and honors for my academic work and have published extensively in the field of economics. These honors, publications and other professional experiences are listed in my curriculum vitae, which is attached hereto as Exhibit 1.

2. My major areas of concentration are private contract, industrial organization and regulation/antitrust economics. I have been certified as an economic expert in these areas in state, federal and international courts. I have done extensive research, publishing and consulting in widely diverse industries such as banking and credit, health care, insurance, publishing, alcohol, agriculture, air traffic control and crime enforcement. In addition, I have done numerous research projects related specifically to

various aspects of the U.S. petroleum industry. These projects have been published in academic journals; presented to various state and federal government agencies, such as the EPA, DOJ and the DOE; presented in testimony before committees of the U.S. Senate, House of Representatives, and several state government agencies; used in litigation involving allegations of contract violations and antitrust violations; or used by various oil companies for internal decision making. These projects are listed in Exhibit 1.

3. Within the petroleum industry, one of my principal areas of investigation is the area of forced contractual change. When the government has proposed or enacted laws that would force changes in private contracts, I have analyzed the predicted or actual consequences of these changes. Examples include laws that would prohibit oil companies and private individuals from contracting for salaried employment in retail gasoline stations, laws that would prohibit oil companies and private individuals from contracting for exclusive supply arrangements and laws that would prohibit oil companies and private individuals from contracting for prices on petroleum products.

4. In forming the opinions expressed here, I have reviewed Act 257, Chevron's complaint and Summary Judgment Motion and the accompanying materials, including the Declaration of Keith B. Leffler submitted on behalf of the defendants. I have relied on my academic training, research and experience in economics and the petroleum industry.

SUMMARY OF OPINIONS

5. I have found the following:

a. Act 257 will penalize Chevron and its lessee-dealers, reducing their viability in Hawaii;

b. Act 257 will penalize consumers because it can be expected to lead to higher retail gasoline prices;

c. Act 257 will not benefit future lessee-dealers who purchase leases from current dealers – they will pay incumbent dealers a premium reflecting any value of the rent control to the dealer;

d. Act 257 will not permit Chevron to charge a service station rent that will allow it to earn a competitive (reasonable) return on its investments in station assets.

BACKGROUND

6. Oil companies have a choice of methods for selling gasoline to the public. They can sell it directly at stations that they own and operate themselves – "company operated stations." They can sell it to individuals who own and operate their own stations and who obtain gasoline from the oil company of their choice – "open" or "two party" dealers. Or they can sell it to individuals who lease and operate stations owned by the oil companies – "lessee" or "three party" dealers. The rent control statute applies only to the latter category – the only ones who have a lease arrangement with the oil companies.

7. For its lessee stations, Chevron purchases the land or leases it from a third party and makes the entire

investment to build the service station and related facilities. Chevron then leases the finished station to a dealer. Chevron incurs ongoing expense associated with the stations, including ground lease rents, real property taxes, Ordinary maintenance and the like.

8. Lessee dealers have two contracts with Chevron. Under the dealer lease, the dealer agrees to pay a monthly rent to Chevron. Under the supply contract, the dealer agrees to buy Chevron-branded gasoline from Chevron at a price unilaterally set by Chevron. (The dealer then sets the retail price at which he resells gasoline to motorists). Historically, the rents charged by Chevron have been insufficient to recover its costs of operating the stations. Instead, Chevron recovers its expenses not only through rent but also through the price of gasoline and other charges.

9. I understand that the parties have stipulated that:

a. Lessee-dealers are permitted to assign their occupancy or franchise rights to others for monetary consideration, subject to Chevron's approval;

b. From 1992 to 1998, 14 Chevron dealers in Hawaii assigned their rights to others, for a range of $80,000 to $500,000;

c. Act 257 does not limit the price at which a lessee dealer can sell, convey or otherwise transfer his or her interest in a service station lease;

d. Assuming everything else remains equal, the market value of the lessee-dealer leasehold reasonably could be expected to increase

as the amount of the rent payable decreases; and

e. As a matter of basic economics, the dealers may be able to sell their leasehold interest at a premium reflecting the rent control.

10. I understand that Act 257 capped the rent that oil companies could charge their dealers at 15% of the dealer's profit on gasoline sales and 15% of the dealer's gross sales on products other than gasoline, plus (where applicable) a percentage increase equal to any increase that the oil company is required to pay on its ground lease. This contrasts with the Chevron rent program which establishes motor fuel rent at a sliding scale of 18% to 38% of the dealers' gross margin on gasoline and other fuel sales.

THE LEASE RENT CAP WILL NOT LESSEN THE ALLEGED ADVERSE COMPETITIVE IMPACTS FROM HIGH CONCENTRATION

11. A well accepted axiom in economics is that individual decision makers try to maximize the net present value of their assets. Indeed, it is this effort to maximize the value of assets that drives the capitalist system. The opportunity to increase their wealth provides the incentive for suppliers to take risks, use valuable resources and sacrifice personal comfort and leisure to produce and sell products. The same opportunity to increase wealth provides incentives for buyers to shop around and buy products through contracts. Thus, oil companies will strive to create contracts with their lessee dealers that generate a revenue flow that will maximize the net present value of their land, stations, gasoline and other assets, subject to the constraint that the dealers can

choose not to agree to the contracts. Similarly, dealers will strive to find contracts with oil companies that will maximize the net present value of their resources, subject to the constraint that the oil companies can choose not to agree to the contracts.

12. Once the contract has been agreed upon, a contractual change, forced upon both contracting parties by an outside third party, will generally reduce the net present value of the revenue stream, reducing the value of the assets to one or both parties.

THE LEASE RENT CAP CAN BE EXPECTED TO LEAD TO FEWER RETAIL GAS STATIONS

13. Virtually every textbook in economics agrees that rent control, to the extent that it reduces the net return to the supplier, will reduce the incentive of the supplier to produce and supply the controlled product. Here, basic economic theory predicts that oil companies will produce fewer gas stations, because the market will force oil companies to reallocate their resources to more productive alternative uses, in locations where they are not penalized for building and renting retail stations. To the extent that rent control benefits dealers, it disadvantages the oil company. And it is the oil company's economics that determines whether it will continue to invest in dealer stations.

THE NUMBER OF SERVICE STATIONS PROVIDED BY OIL COMPANIES WILL BE REDUCED

14. From this simple principle, we can derive several conclusions. First, there is no basis for a claim that this rent control (Act 257) will "lessen the anticompetitive

impact of high concentration." Concentration, as typically measured by economists, is simply a measure of the percent of a market currently being supplied by different sellers. If each oil company equally reduces its number of gasoline stations by the same percent, the brand concentration levels will be unchanged; there will just be fewer stations. Beyond that statement, regardless of how we calculate market concentration, the Hawaiian rent control law will have an indeterminate effect on concentration levels.

15. While the effect on concentration is indeterminate, it is clear that the service station rent control penalizes the suppliers of lessee-dealer stations, reduces the net present value of their rental revenue and reduces their incentive to build new stations or maintain old ones. As a result, the total number of stations in the market will be smaller. Consumers will have fewer choices of stations over time.

THE LEASE RENT CAP WILL NOT MAINTAIN THE PRESENCE OF LESSEE-DEALERS IN HAWAII; IT WILL REDUCE THEIR NUMBERS

16. The rent control will not serve to maintain the number of lessee dealers in Hawaii. First, as shown above, by reducing the net present value of the revenue stream derived from rent and penalizing the supplier of stations, rent control will, in time, reduce the total number of stations that would otherwise exist in Hawaii. Oil companies have a number of alternatives from which to choose in deciding how to operate a service station. For example, aside from leasing a station to a dealer, an oil company can put salaried employees in the station. Or it can sell the station outright and then contract to be the gasoline

supplier. It can also lease the convenience store or car wash to a dealer and keep the gasoline islands and pumps, paying the dealer a commission to sell the gasoline. Oil companies can co-brand with fast food chains and pay the franchisee for the right to sell gasoline at their restaurants. They can also get out of the station owning business entirely and contract with a jobber to supply the gasoline. The jobber in turn may operate his stations with salaried employees, commission or consignment franchisees or lessee dealers, or use any one of a number of alternative contractual arrangements.

17. The Hawaii rent control law singles out lessee-dealer stations and penalizes them relative to the other alternatives. In addition to ultimately resulting in a smaller number of stations in total, the rent control will alter the gains and costs of various modes of station operation, forcing the oil companies to choose fewer of the lessee-dealers and more of the other alternatives. Thus, the rent control will lead to fewer dealers at the retail level, and competition at the retail level will not be enhanced.

THERE IS NO BENEFICIAL IMPACT ON GASOLINE PRICES IN HAWAII AS A RESULT OF THE RENT CONTROL

18. The rent cap will actually cause retail gasoline prices to increase, in the short run and the long run.

19. Because rent control will reduce the incentive for oil companies to build new stations and maintain old ones, it will lead, in the long run, to fewer stations. According to the State's own logic (see Leffler Decl., footnote 5), "this

will increase the demand facing the surviving dealers and motivate and allow them to raise price."

20. The short run effect on price is more subtle. Dr. Leffler acknowledges that "A wholesaler of gasoline can impact the economic viability of its dealers through two variables, the rent and the wholesale gasoline price it charges." When rent control reduces the net present value of the revenue stream from station rents, oil companies can recoup at least part of this lost value by increasing the wholesale price of gasoline. Indeed, the market wholesale price is likely to increase to the extent that oil companies are impacted by rent control. To the extent that rent is directly related to gasoline sales and can be translated to a cents per gallon figure, a forced reduction in rent which is offset by an equal increase in wholesale gasoline price will not lead the dealer to change his retail gasoline price. That is because his overall costs on a per gallon basis will remain the same. In this example, the rent control will not promote the State's interest in lower gasoline prices. Indeed, even in this example, because the split between rent and the wholesale gasoline price is different from the split considered optimal by the company, the altered split can be expected to lead to inefficiencies and therefore to higher retail prices.

21. If, on the other hand, a dealer raises his retail prices because his wholesale gasoline price has increased, either stations in competition with the dealer will raise their prices and the dealer will sell about the same volume as before or, if competition does not respond immediately, customers may switch to a lower-priced dealer. The increase in demand for the other dealer, in turn, will lead him to raise prices. So one way or the other, consumers

will end up paying more for gasoline in the vicinity of stations that are impacted by the rent control.

22. Contrary to Dr. Leffler's assertion, the possibility that Chevron's sales volume will decrease if it increases its wholesale price will not prevent Chevron from raising its price to offset rent reduction. This is because its losses from the rent reduction without any increase in the gasoline price will be greater than if it recoups part of the rent reduction by raising its gasoline price even if it loses some volume. Plus, if competitors raise their prices as well, the loss in volume will be smaller if not negligible.

RICHARDSON PREMIUM TRANSFER ISSUE

23. The incumbent dealer will be able to capture any premium created by the rent control when selling his dealership rights to a new dealer. The premium will reflect the difference between the incumbent dealer's expected market rent and his lower rent as a result of Act 257, discounted by the appropriate interest rate for the expected life of the station.

24. The State's arguments do not disprove this fundamental point. Beginning on page 8 of his declaration, paragraph 12, Dr. Leffler states that even if the current lessee dealer captures all of the net present value of the rent reduction when he transfers his lease to a "new" lessee-dealer, the new lessee-dealer will still benefit from the rent control. The source of this benefit, according to Dr. Leffler, comes from " . . . lower monthly rent payments (that) reduce the new dealer's cost of *continued* operation." According to Dr. Leffler, this reduction in the new dealer's operating cost comes from the fact that he paid the original dealer a lease purchase price that included a lump

sum payment equal to the present value of the expected reduction in the continued operating cost. Once paid, the future operating costs of the dealer, in cash flow, will be lower by the amount of the ongoing rent reduction. Dr. Leffler claims that this will help the new dealer by allowing him to remain in business, when and if gasoline revenues decline, longer than he would absent the rent reduction. There are several things wrong with Dr. Leffler's analysis.

25. Even if there were some increase in the original dealer's net earnings and they were fully captured by the original dealer in the lease transfer, as Dr. Leffler assumes in his example, the new dealer would not have lower operating costs. This is because the new dealer, like the original, has the opportunity to resell the lease and capitalize the present value of the lower rent. If the market conditions have not changed from the time of the first transfer, the new dealer can resell the lease for exactly the same price as he paid. Because the opportunity exists for the new dealer to resell the lease, the rent reduction is no longer a fixed cost. It may be true that his required operating "cash flow" is lower, but his full operating costs must now include the interest on the money the new dealer could have if he resold the lease. This will be exactly equal to the reduction in the monthly rent. Dr. Leffler acknowledges the fact that if the new dealer borrowed the money to buy the lease there would be no reduction in the new dealer's operating costs. However, he is confused when he suggests that the lessee-dealer could use the station as collateral on the loan. The station and the land belong to the oil company and cannot be used by the dealer to secure his loan.

26. Even if we grant Dr. Leffler all of the elements of his example, his conclusion still does not follow from his assumptions. The reason is that the decision on whether or not to stop operating the station is not entirely the dealer's. The new lessee-dealer can certainly quit operating the station, but the oil company that owns the station chooses when to remove it from the market. When, as Dr. Leffler assumes, " . . . adverse events . . . " occur that reduce the dealer's net income, the amount he pays to the oil company will fall. When this payment fails to cover the economic cost to the oil company, it can shut the station down. A rent reduction, to the extent that it exists and is fully captured by the original dealer, does not give the new dealer any advantage in terms of staying in the market longer. In fact, because it is the oil company's decision whether or not to keep the station open, and to the extent that the rent the oil company can earn is constrained by the law, the station will actually be closed or converted from lessee-dealer earlier than it would be without the law.

27. It is true that a supplier's decision whether to close a station is affected by Federal law, the Petroleum Marketing Practice Act (PMPA). For example, the oil company may have to first offer the station to the existing dealer for sale. Of course, if the dealer purchases the station he will no longer be a lessee dealer but will now own the assets and bear the full economic cost of ownership and operation. In any event, as I understand it, the PMPA does not require a supplier to continue leasing a station that is uneconomic due to rent control or other reasons.

28. Dr. Leffler argues that rent reductions will not be fully capitalized in subsequent transfer prices. He offers

several reasons for his conclusion. He claims that part of the rent reduction will be passed on to the consumers of gasoline through lower retail prices. I have already shown this argument to be false. The rent reduction will have the effect of increasing retail prices in both short and long run. Consumers will be hurt by the rent control law.

29. Dr. Leffler claims that because other factors, which might change in unforeseeable ways, affect the gross profit margins of dealers, it is unlikely that anyone could accurately forecast the effect of the rent control law. He goes on to state that we might expect them, on average, to correctly forecast but that would imply that half of the new buyers would undercapitalize the benefits and these individuals would be "direct beneficiaries of Act 257." There are three points to note concerning this part of Dr. Leffler's assertions. Economic theory does deal with future uncertainties that arise out of imperfect information. These models predict that "expected" future benefits will be capitalized in the transfer price of assets. Economic theory does not deny that future returns to dealers will depend upon a variety of factors other than just the law or Chevron's rent policy. Holding these other things constant, we predict that expected future returns will be captured in the lease transfer. If, after the lease transfer, other things change, it does not alter the fact that the lease transfer captured the expected gains from the rent control. For example the new dealer could get run over by a careless driver and killed the day after buying his lease. In this case his net present value would instantly fall to zero, due to an unforeseeable change in circumstances, but it does not mean he incorrectly capitalized the expected rent control gains at the time of the lease purchase.

30. Most importantly, Dr. Leffler's statement that half the dealers would pay a premium less than the actual present value of the rent reduction ignores the fact that half would pay a premium greater than the actual present value. These dealers would presumably be harmed by Act 257. However, on average, the expected net benefits to future dealers would be zero, even in Dr. Leffler's analysis.

31. The fact that there are relatively few lease transfers in any given year does not imply a lack of competition. Furthermore, full capture of benefits does not require a large number of sellers. Contrary to Dr. Leffler's assertion, the number of actual lease transfers tells us nothing about the competitive nature of the market. At any point in time there may be many individuals who are interested in buying a station lease. These individuals may be bidding against each other for just one lease, like an auction with many "potential" buyers. Competition among these buyers will drive the price of the lease up. Will this competition drive the lease price up to the point where the original dealer captures all of the future benefits? The original dealer has the choice of staying in the station and earning any of the benefits that might have come to him because of the rent control. He will only sell the station if the offer price has a present value equal to the present value of his expected income stream. This suggests that the lease sale price will capture the original dealer's expected future value.

32. Dr. Leffler's assertion in paragraph 19 of his declaration that buyers and sellers may have different expectations of the future effects of the rent control, so that a bargaining process that depends on "negotiation skills" results, is just a restatement of the argument he makes earlier. Dr. Leffler believes that on average expectations of

buyers and sellers will be correct. Similarly, in the absence of any reliable way to predict or measure the distribution of "negotiation skills," we would expect them to be randomly distributed among buyers and sellers. Therefore, on average we would expect the final lease transfer price to capture the expected future benefits of the rent control. While half of the transfers would undercapitalize the true gains, half would overcapitalize the true gains and, on average, no new dealer would benefit from the rent cap.

THE RENT CONTROL PREVENTS CHEVRON FROM CHARGING A STATION RENT THAT WILL COVER ITS ECONOMIC COSTS OF OWNERSHIP AND OPERATION AT THE MARGINAL STATION

33. In paragraph 22, Dr. Leffler recognizes that Chevron's rental revenues are not sufficient to cover even its accounting costs of station ownership and operation. One obvious implication of this is that if gasoline profits decline to the point where they only yield a "reasonable" return on gasoline costs, then the rent control would not allow a "reasonable" return on the station property. For Dr. Leffler, the "reasonableness" of the legal service station rent is entirely dependent on the profitability of another product, gasoline.

34. Dr. Leffler then devotes a good deal of time demonstrating that Chevron's combined gasoline revenue and rent generates a **total** return to Chevron on its investments that more than covers the full economic cost of the stations. However, his entire discussion is irrelevant as it misses the fundamental economic issue involved in this case. Virtually every economics textbook informs us that optimization decisions are made at the margin and

not in total. In other words, how much net revenue Chevron makes on all of its retail station assets in Hawaii is really not at issue. Rather it is the net revenue it makes on a marginal or extra station that matters. To illustrate, suppose that Chevron has two retail stations in Hawaii. The first station generates $1 million dollars in net revenue (revenue minus the full economic cost of the station) while the second station generates an extra $10 in net revenue. Dr. Leffler would point out that the two stations combined have earned $1,000,010 in net earnings for Chevron and that a small reduction in rental revenue from the rent control law will not significantly effect Chevron's ability to cover its station costs. However, notice that if the rent control reduces the revenue flow at the second (marginal) station by more than $10, Chevron would optimize its asset holdings by closing the second station. Total returns to assets are irrelevant to this issue. Marginal returns are the key. At this margin, the incentive to open new stations or maintain existing stations will be reduced by the rent control. There will be fewer stations in the future, less choice and higher prices for consumers.

CONCLUSIONS

35. If we are to believe Dr. Leffler, the Hawaiian rent control law is truly a remarkable piece of legislation. According to Dr. Leffler, so far, Chevron has actually earned more total rent than it would have without the law; consumers benefited through lower retail prices; current lessee-dealers had an increase in their net profits and future dealers benefited by purchasing the leases at prices below the true market value. It sounds too good to be true. More complete economic analysis suggests that Dr. Leffler is

incorrect on virtually every point. Fundamental economics indicate that Chevron will in fact be penalized for operating lessee-dealer stations; consumers will pay higher prices for their gasoline; lessee-dealers will not see an increase in their net income, rather they will lose as the incentive to maintain a lessee-dealer network will be reduced; future dealers will be disadvantaged as there will be fewer lessee-dealer stations built and maintained by the oil companies as they switch into alternative modes of station operation and reallocate their resources to other areas where the laws do not penalize them for leasing to dealers.

[Certificate Of Service Omitted In Printing]

EXHIBIT 1

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Date of Birth:	April 21, 1945

Education

BA. Occidental College, Los Angeles, California, 1967
M.A. University of California, Los Angeles, 1968
Ph.D. University of Washington, Seattle, 1976

Academic Experience

1968-1971 Assistant Professor of Economics, California State Polytechnic College, San Luis Obispo, California

1971-1974 Teaching and Research Assistant, University of Washington, Seattle Washington

1974-1975 Assistant Professor of Economics, Virginia Polytechnic Institute and State University, Blacksburg, Virginia

1975-1981 Assistant Professor of Economics, Purdue University, West Lafayette, Indiana

1981-1988 Associate Professor of Economics, Purdue University, West Lafayette, Indiana

1988- Professor of Economics, Purdue University, West Lafayette, Indiana

Awards and Grants

Research Awards

Best Research Article of the Year, Published by the Western Economic Association, 1981, awarded for "Might Makes Rights: A Theory of the Formation and Initial Distribution of Property Rights."

Best Research Article of the Year, Published by the Western Economic Association, 1991, Runner-up awarded for "Screening and Signaling in Credit Markets," co-authored.

Research Honors

I have appeared on or my research has been cited in the following: N.B.C. National News, A.B.C. National News, The Wall Street Journal, Good Morning America, Forbes Magazine, New York Times, CNN News, Time Magazine, Readers Digest and Paul Harvey News.

My earlier research on the formation of property rights was selected for a collection of articles in honor of the Nobel Prize winner, Ronald Coase.

Research Grants

National Science Foundation – for the Investigation of Contracts, S.N.S. Cheung, Principal Investigator, 1974.

Foundation for Research in Economics and Education – for the Study of Contracts, 1975.

Krannert Graduate School of Management – for the Study of Contracts, summer, 1976, 1977, 1980, 1988, 1989.

Federal Trade Commission – for the Study of the Holder-In-Due-Course, through the Credit Research Center, 1979.

Carthage Foundation – for the Study of Contract Incentives of Federal Data Collectors, 1982 (with J. Barron).

Carthage Foundation – for the Study of Insurance Claim Filing Patterns, 1982-1983. Arthur Andersen – for the Study of Drunk Driving Laws, summer, 1987.

Krannert Graduate School of Management – for the Study of Petroleum Marketing Practices, summer 1990, 1991.

Krannert Graduate School of Management – for the Study of Predatory Pricing with Financial Markets 1992

Teaching Awards

Outstanding Teacher of the Year (teaching undergraduates) 1985 winner. School of Business, Purdue University.

Outstanding Teacher – G.E. Executive Masters Program, (teaching executives) 1985, Purdue University.

Outstanding Teacher of the Year (teaching undergraduates) 1970 runner-up. California Slate Polytechnic College, San Luis Obispo, CA.

Outstanding Teacher of the Year (teaching undergraduates) 1973 runner-up. University of Washington, Seattle, WA.

Outstanding Teacher of the Year (teaching undergraduates) 1976, 1979, 1980, 1981, 1982,

1983, 1994, runner-up. School of Business, Purdue University, West Lafayette, IN.

Outstanding Teacher of the Year (teaching graduates) 1978 runner-up. School of Business, Purdue University.

Research

Publications

Books

A Theory of Property Rights, Iowa State University Press, Ames, IA (1981)

Health Care Economics (1981) for Blue Cross/Blue Shield

Health Care Economics (1985) Revised (with W. Dunkelberg)

Health Care Economics (1987) Revised (with W. Dunkelberg)

Journal Articles

"The California Gold Rush: A Study of Emerging Property Rights," *Explorations in Economic History*, August 1977.

"A Theory of Contract Choice," *Journal of Law and Economics*. October 1977.

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"The Welfare Effects of Sales Maximization: A Methodological Critique," *Economic Inquiry*, January 1979.

"Shipping the Good Apples Out: Some Ambiguities in the Interpretation of Fixed Charge," *Journal of Political Economy*, February 1980.

"Might Makes Rights: A Theory of the Formation and Initial Distribution of Property Rights," *Economic Inquiry*, January 1981. (Winner of "Best Research Article of the Year" by the Western Economic Association.)

Reprinted in *The Legacy of Ronald Coase in Economic Analysis*, Edward Elgar Publishing Ltd. Cheltenham, Glos, UK., 1997.

Reprinted in *The Economic Foundations of Property rights: Selected Readings*, Edward Elgar Publishing Ltd. Cheltenham, Glos, U.K., 1997.

"Information Costs, Risk, and Creditors' Remedies" (with R. Chatfield), *Journal of Money. Credit and Banking*, December 1982,

"Information Costs and Incentives to Shirk: Disability Compensation of Air Traffic Controllers" (with M. Staten) *American Economic Review*, December 1982. Alternative versions or excerpts published in the following:

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Law Firm: Sommer & Barnard
Attorney: William C. Barnard
Indianapolis, IN

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Law Firm: Lange, Simpson, Robinson & Somerville
Attorney: Lawrence B. Clark
Birmingham, AL

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Law Firm: Huey, Guilday, Kuersteiner & Hecker, P.A.
Attorney: Geoffrey B. Schwartz
Tallahassee, FL

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Law Firm: Dykema, Gossett, Spencer, Goodnow, & Trigg
Attorney: Barbara L. Goldman
Detroit, MI

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Law Firm: Baker & Daniels
Attorney: Kevin Toner
Indianapolis, IN

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Law Firm Collier, Shannon, Rill & Scott
Attorney: John Williams
Washington, DC

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Law Firm: Tuttle & Taylor
Attorney: Diann Kim
Los Angeles, CA

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Law Finn: Tabbert, Cramer, & Capehart
Attorney: Charles F. Cromer, Jr.
Indianapolis, IN

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Law Firm: Robins, Zelle, Larson & Kaplan
Attorney: Lawrence T. Hofmann
Minneapolis, MN

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Law Firm: Barnes & Thornberg
Attorney: Don Knebel
Indianapolis, IN

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Law Firm: Foley & Lardner
Attorney: Robert DuPuy
Milwaukee, WI

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Law Firm: Reed, Smith, Shaw & McClay
Attorney: Daniel I. Booker
Pittsburgh, PA

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Law Firm: Richard Neuman
Attorney: Richard E. Neuman
San Francisco, CA

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Law Firm: Howrey & Simon
Attorney: Dave Kaplan
Washington, DC

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Law Firm: Williams & Connolly
Attorney: Stephen L. Urbanczyk
Washington, DC

John L. Baltz, et al., v. Bulk Petroleum Corporation
Law Firm: Foley & Lardner
Attorney: Robert DuPuy
Milwaukee, WI

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Law Film: Texaco, Inc.
Attorney: Joseph P. Foley
White Plains, NY

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Law Firm: Kirkland & Ellis
Attorney: Jack A. Rovner
Chicago, IL

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Law Firm: Texaco Inc.
Attorney: Terri J. Frank
White Plains, NY

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Law Firm: Sommer & Barnard
Attorney: Gordon L. Pittenger
Indianapolis, IN

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Law Firm: Paxton & Seasongood
Attorney: Jacob Stein
Cincinnati, OH
Law Firm: Wildman, Harrold, Allen & Dixon
Attorney: Mike Grant Chicago, IL

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Law Firm: Barnes & Thornberg
Attorney: Don Kriebel
Indianapolis, IN

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Law Firm: Sommer & Barnard
Attorney: William Barnard
Indianapolis, IN

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Law Firm: Pillsbury, Madison & Sutro
Attorney: Roxane Polidora
San Francisco, CA

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Law firm: Brobeck, Phleger & Harrison
Attorney: Earle Miller
Los Angeles, CA.

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Law firm: Mallery & Zimmerman, S.C.
Attorney: Thomas F. Mallery
Wausau, WI

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Law film: Smaltz & Anderson
Attorney: Don Smaltz
Los Angeles, CA

MDL 150
Law firm: Pillsbury Madison & Sutra
Attorney: Robert A. Mittelstaedt
San Francisco, CA

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Exxon Attorney: Greg Vint
Law firm: Goodwin & Goodwin
Attorney: Tom Goodwin
Charleston, WV

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Law firm: Sommer & Barnard
Attorney: Edward W. Harris III
Indianapolis, IN

Corp v. Kinnear
Law firm: Lee, Smart, Cook, Martin & Patterson, P.S., Inc.
Attorney Joel E. Wright
Seattle, WA

Hilo v. Exxon
Law firm: Pillsbury Madison & Sutro
Attorney: Robert A. Mittelstaedt
San Francisco, CA

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Law firm: Balch & Bingham
Attorney: Cavender C. Kimble
Birmingham, AL

The National Bond Fund, et al. v. Circle Express, Inc., et al.
Law firm: Sidley & Austin
Attorney: John M. George, Jr.
Chicago, IL

Bohan v. Unocal
Law firm: Wilner, Klein & Siegel
Attorney: Samuel Wilner
Beverly Hills, CA.

El Paso Refinery, L.P.
Law firm: Pillsbury Madison & Sutro
Attorney: Philip S. Warden
San Francisco, CA.

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Law firm: Hogan and Hartson
Attorney: Edward C. Duekers
Washington D.C.

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Law firm: ARCO
Attorney: Ron Redcay
Los Angeles, CA

Norman Law, et al. V. NCAA
Law firm: Sommer & Barnard
Attorney: William C. Barnard
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Law firm Mayer, Brown & Platt
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Consulting

National Committee on Electronic Funds Transfer Systems

Great Lakes Chemical Corporation

Blue Cross/Blue Shield, National Association

Marathon Oil Company

Indiana Petroleum Council

Committee of Independent Refiner Marketers

Associated Petroleum Industries of Pennsylvania

Jones and Laughlin Steel Corporation

Atlantic Richfield Company

R.R. Donnelly and Sons Company

Conoco, Inc.

Public Service Indiana

Delaware Petroleum Council

General Electric Company

Texaco, Inc.

Amoco

Southland Corporation

Blue Cross Indiana

Ashland Oil Inc.

Indiana State Farm Co-op.

E. & J. Gallo Winery

Indiana Corn Growers Association

Archer Daniels Midland

South Point Ethanol

Anheuser-Busch, Inc.

British Petroleum

Chevron

Cohn and Son, Inc.

Florida Petroleum Council

Lazzara Oil Co. Inc.

First Financial Bank, FSB

Exxon

Standard Oil of Ohio

Time Oil Inc.

Mobil Oil Corp.

Standard Oil of California

American Petroleum Institute

Michigan Petroleum Council

Blue Cross and Blue Shield of Alabama

Unocal

Western States Petroleum Association

Cumberland Farms

Business Experience

Board of Directors – Nova Concepts, Inc. 1984-1992

Board of Directors – Phytodynamics, Inc. 1987-1988

Board of Directors – Qualitron, Inc. 1992-1998

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A. INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI, Attorney General of the State of Hawaii, Defendants.	CIVIL NO. 97-00933 SOM (Constitutionality of State Statute) DIRECT TESTIMONY BY DECLARATION OF EXPERT WITNESS KEITH LEFFLER; EXHIBIT "1"; CERTIFICATE OF SERVICE Trial Date: February 26, 2002 Judge: Hon. Susan O. Mollway (Filed Feb. 25, 2002)

DIRECT TESTIMONY BY DECLARATION OF EXPERT WITNESS KEITH LEFFLER

Qualifications

1. I, Keith Leffler, am an Associate Professor of Economics at the University of Washington. I have a Ph.D. in economics from UCLA. I teach Microeconomics and

Antitrust Economics. I have taught antitrust economics and industrial organization at the Ph.D. level for over twenty years. A resume summarizing my academic experience, publications, and litigation and consulting experience is attached as Exhibit "1" and incorporated herein.

2. I have served as an economic consultant for state and federal governments and for numerous law firms and corporations. I have been qualified as an economic expert in industrial organization and antitrust economics in proceedings before state and federal courts and various federal agencies.

3. I have particular experience in the economic analysis and study of the petroleum industry. I spent parts of fifteen years working with the state attorneys general of Arizona, California, Washington, and Oregon, studying the petroleum industry in my consulting work on the Coordinated Petroleum Products Case known as MDL 150. I also evaluated the effects of the Exxon Valdez spill on gasoline prices for the states of Idaho, Oregon, and Washington. I assisted the states of Arizona and California in evaluating the competitiveness of gasoline prices throughout the state. I have also consulted in a number of gasoline dealer cases involving the competitive impact of pricing and rent policies.

4. I have assisted the Federal Trade Commission, the Department of Justice and the state attorneys general in the study of the likely impact on consumers from mergers in the petroleum industry. I was the economist for the Federal Trade Commission in their evaluation of the competitive impact of the merger of Standard and Gulf Oil. I was also the FTC's economist in a number of other petroleum mergers including PRI-Shell in Hawaii, Shell-Mobil in Guam, and Marathon-Ashland on the mainland. I

also assisted state attorneys general in petroleum related merger evaluations including Mobil-BP, BP-Tosco, ARCO-Thrifty, Tosco-Unocal, Shell-Texaco, BP-Arco and Chevron-Texaco.

5. My petroleum related work has included a number of studies of the market in Hawaii. In addition to merger evaluations related to PRI-Shell, Shell-Texaco and Chevron-Texaco, I also assisted the Hawaii State Attorney General in the evaluation of gasoline prices in Hawaii in the early and mid 1990's, performed an evaluation of the prices and performance of the Chevron Hawaii refinery as compared to its west coast refineries, and provided opinions in connection with the state attorney general's antitrust lawsuit involving gasoline pricing in Hawaii. In each of these projects, I had to become quite familiar with the supply sources, competitors, and the markets for petroleum products in Hawaii.

Materials Reviewed

6. I have worked with the Hawaii state attorney general's office in evaluating the likely impact of the rental aspects of Act 257 since November 1997. I have reviewed Act 257 and its precedent bills in both Houses. I have also reviewed Chevron's complaint, the Stipulation of Facts, Professor Umbeck's Declarations, the parties' filings in connection with their cross-motions for summary judgment and the courts' rulings relating to same. I have had access to the materials Chevron has provided the attorney general and I have studied and reviewed these materials. I have also relied on my background and experience in the economics of the petroleum industry and my professional training.

Summary of Opinions

7. A short summary of my opinions is as follows:

a. The lease rent cap imposed by Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline markets in Hawaii by maintaining the viability of independent dealers and thereby benefit consumers by reducing gasoline prices below what they would be otherwise.

b. An oil company is unlikely to raise its wholesale price of gasoline to offset lost rental revenue due to the imposition of Act 257, if any, because its wholesale price is already set at the profit-maximizing level.

c. Whether current dealers capture a "premium" when selling their dealer rights will not negate the beneficial impact of Act 257.

The Lease Rent Cap Will Lessen the Adverse Competitive Impacts from High Concentration

8. Act 257's "Legislative findings and declarations" or preamble provides in relevant part as follows:

> (4) Because Hawaii is a physically small and geographically remote economy, certain of its markets tend to be concentrated. Market concentration is a function of the number of firms in the market and their respective market shares. In a highly concentrated market, market prices tend to rise above competitive levels. Market prices persistently above competitive levels are harmful to the consumers and the public. Barriers to competition tend to cause supra competitive prices to persist; and

(5) The markets for oil and oil products in Hawaii are highly concentrated markets.

9. The highly concentrated gasoline industry in Hawaii is economically described as an oligopoly which is a market with few sellers. In 1997, Hawaii had two refineries that supplied gasoline to essentially six wholesalers.

10. In a competitive market, one with many sellers, each seller is not individually significant enough to have a measurable impact on the industry supply. The sellers therefore act independently of each other. In a highly concentrated market, however, each seller will recognize that its decision will have significant impact on the market and on the other competitors. Each seller will therefore take into account how its competitors will react to its decisions about marketing, supply and price. The sellers are described as being interdependent rather than independent competitors. There is an economic expectation of reduced competition because of the high concentration. A characteristic of oligopoly is that individual firms pursuing their own individual interests will not "rock the boat" and will try to avoid price wars and battles for market share. A concern is that high concentration may have the anticompetitive effect of tacit or effective cooperation rather than competition among the few firms resulting in high prices to consumers.

11. While the supply of gasoline at wholesale in Hawaii is highly concentrated, the retailing of gasoline is not. Hawaii has many retail gasoline stations, although the number is declining. Some of these stations are oil company owned and operated, a few are owned by the parties operating them, others are owned by oil companies but leased to dealers who have a franchise or lessee dealer

agreement with the oil company that owns the property. Act 257 concerns lessee dealer stations.

12. Because there are many decision makers involved in the retailing of gasoline in Hawaii, there is a strong economic expectation that the pricing at retail will be competitive. The street price of gasoline to the consumers in Hawaii is therefore expected to be the sum of the oligopolistic wholesale price plus a competitive retail margin. That average competitive retail margin will be determined by the number of competing retail stations in an area, the specific locations of the stations, and the quality of the stations including such factors as street presence and ease of ingress and egress.

13. Act 257's cap on the rent amounts charged lessee dealers, will lessen the anticompetitive impact of high concentration in the gasoline market in Hawaii in two ways. First, Lessee dealers are independent price setters that compete with one another and with company operated stations. The more competition and independent price setters at the retail level the better. By protecting lessee dealers and maintaining their presence in the market, the rent cap tends to prevent increased concentration at the retail level. Intraband and interbrand competition at the retail level are thus enhanced.

14. Second, Act 257, by maintaining the presence of independent lessee dealers in the retail market, also acts as a deterrent to cooperative pricing among the few suppliers of gasoline at the wholesale level. The likelihood of cooperation in oligopolistic pricing of gasoline is enhanced if the suppliers can more easily determine the prices of their competitors. The prices to the petroleum companies' dealers are not public prices. The petroleum

companies subscribe to information services such as Lundberg that collect and report the prices to the dealers; however, these sources of information about competitors' prices are both incomplete and delayed. This offers an individual wholesale supplier with an opportunity to shade price to some of its dealers and try to increase market share. These opportunities to profitably compete are more likely to occur if the competitors cannot immediately detect and react to such competitive pricing.

15. The presence of the independent dealers obscures to the other suppliers the wholesale prices actually being charged. Since an observed lower street price may be the result of a more competitive wholesale price or rather the result of a dealer aggressively competing at retail. The effective coordination of pricing by oligopolists requires an effective means for each of the few sellers to monitor the pricing activities of their competitors. When the street prices are, in part, a result of the independent business decisions of a host of lessee dealers, the ability to monitor the pricing actions of the few wholesale oligopoly suppliers is made more difficult. This increased price monitoring cost disrupts, to some degree, the oligopolistic price coordination at the wholesale level. By protecting the viability of the independent lessee dealers, the rent cap provisions of Act 257 make cooperation in the highly concentrated petroleum markers in Hawaii more difficult. If the lessee dealers were no longer an active competitive force in the Hawaii gasoline market, then I would expect that there would be an increase in the wholesale gasoline prices due to increased cooperation among the relatively few suppliers of gasoline. The higher wholesale prices would in turn lead to higher retail prices to consumers.

16. Act 257 raises the cost of any attempts by a petroleum company to drive its dealers from the market and is thereby lessens the adverse effects of the highly concentrated gasoline markers in Hawaii. A wholesaler of gasoline can impact the economic viability of its dealers through two variables, the rent and the wholesale gasoline (dealer tankwagon or DTW) price it charges. Raising the DTW price is, however, relatively costly to the wholesaler as compared to a rental increase as the former likely will lead directly to reductions in volume as dealers react by raising their street price. Act 257 limits the petroleum companies' ability to adjust optimally the mix of DTW and rent in an attempt to drive dealers from the market. Thus, by increasing the cost of driving lessee dealers from the market, Act 257 perpetuates the beneficial impact of independent lessee dealers in a market that is highly concentrated at the wholesale level.

17. It is unlikely that the oil company will increase its DTW price to offset any lost rental revenue that might occur as a consequence of Act 257. The best wholesale price depends upon demand, supply, and the interrelationships among the few suppliers. Neither supply, demand nor the interrelationships among the suppliers are expected to change because a oil company is unable to increase the rent to its dealers. Therefore, the best, profit-maximizing price to the dealers does not depend upon the rent levels. If the oil company could increase its price to dealers and thereby increase its profits from the sale of gasoline, it would do so, and it would do so regardless of Act 257.

18. If higher DTW prices increase the profits from gasoline sales through dealers, then higher prices are expected to be charged. This expectation has nothing to do

with the level of rental revenue. Oil companies could offset any lost rental revenue by increasing DTW prices only if they were not already charging the best, profit-maximizing prices. Economic analysis assumes companies set profit-maximizing prices. Therefore, the DTW price increase offset possibility is inconsistent with basic economic principles.

19. Act 257 will constrain the oil companies from rent increases that make dealer stations unprofitable, thereby increasing the viability of the of the lessee dealer network. Act 257 is not expected to have any significant adverse effect upon the oil companies decisions to invest in their dealer network for a number of reasons. First, the petroleum companies are generally not expanding their dealer networks anyway. Hence, the possibility that Act 257 will reduce their incentives to expand the dealer network is of little practical significance. Second, as regards to current dealers, the protections of the federal Petroleum Marketing Practices Act constrain any reduced incentives to maintain or support current dealers. In addition, the investment decisions will be guided by the additional profits from additional sales that result from the investments, and these additional profits result from gasoline sales not rents. Finally, the current and planned rents are generally below those allowed by Act 257. Therefore, Act 257 should mainly restrain substantial rental increases that might be designed to reduce or eliminate the dealer network, and this restraint simply has nothing to do with maintenance incentives.

20. Standard textbook economic analysis of rent control is irrelevant to the analysis of Act 257 because the standard analysis is in the context of competitive residential landlord/tenant markets. The standard analysis

presumes that the rent controls are designed to aid renters. The standard analysis, therefore, emphasizes the adverse effects on competitive landlords' incentives to maintain and expand the supply of rental housing. Act 257, however, is intended to constrain the above competitive prices in the highly concentrated, non-competitive gasoline supply market. The impact is generally not to benefit dealers immediately but to prevent future actions injuring the dealers. In fact, standard economic analysis does show that the traditional adverse effects of price controls that reduce supply, may not occur in non-competitive markets but, rather, that the price control can increase supply when competition is not present.

<u>The Beneficial Impacts on Gasoline Prices In Hawaii Result Regardless of Whether the Cost Reductions are Captured by Current Dealers</u>

21. The beneficial impacts from Act 257 occur regardless of whether current dealers could capture the entire value of any rent reductions in subsequent transfers. Whether a premium is captured is, therefore, irrelevant to the Act's intended impact of constraining the anti-competitive price effects in a highly concentrated market.

22. If a particular Chevron lessee dealer did successfully increase the sale price for transferring the rights to operate the station by the full present value of any unknown and uncertain rental reductions that might be caused by Act 257, the new dealer would not have any direct economic benefit from the Act. Nonetheless, the viability of the station after the transfer would be favorably impacted. The impact on the viability of the new dealer occurs because, independent of any changes in the up-front price that a new dealer pays to an incumbent dealer,

lower monthly rent payments reduce the new dealer's cost of *continued* operation. The purchase cost of the right to operate a station is economically known as a sunk or fixed cost. The new dealer is out the sunk cost the day he buys the station. This cost is sunk regardless of whether the station continues in operation or shuts down. It is a basic economic proposition that sunk costs do not affect marginal decisions. "Fixed costs, by definition, occur independently of how much the firm produces, or whether it produces at all. Since they are sunk, and the firm cannot recover them, they cannot affect behavior," G. Silberberg, *Principles of Microeconomics*, 1995, Prentice Hall, p. 261; "(An initial investment cost) is sunk and gone, and is irrelevant for any costs of operation once the investment is made. It doesn't appear in future production costs, and the investor hopes to recover it from future revenues, taking a loss if he does not." A. Alchian and W. Allen, *Exchange and Production: Competition, Coordination, & Control*, 1983, Wadsworth, p. 209. The relevant marginal decision, in this context, is whether or not to keep operating a lessee dealer station. The amount of the up-front purchase price does not affect this marginal decision. Rather the revenues from continued operation as compared to the costs of continued operation are what matter.

23. An example illustrates the effect of Act 257 in this regard. Assume the Act cuts a dealer's rent from $5,000 to $4,000 per month. As long as the dealer's net income (after paying all expenses but rent) from gasoline sales exceeds $4,000 per month, the dealer is better off continuing in operation rather than shutting down. Now assume the dealer sells his station right and, because of the reduced rent, receives an additional $100,000, assumed to be the full present value of lower rent, The new

dealer would, of course, only pay this additional amount because of the expectation of in fact receiving the extra $1,000 per month. If, however, adverse events occurred that lowered the net income, it would be in the economic best interests of the new dealer, just like the original dealer, to continue in business as long as the lower net income continued to exceed the reduced rent; that is, as long as the net income exceeded the reduced $4,000 rent. Thus, the beneficial effects of Act 257 on lessee dealers' continued business operation occurs independently of whether the incumbent dealers capture rent reductions in subsequent sale prices. Act 257 therefore lessens the impact of the high concentration in Hawaii's petroleum markets by increasing the viability of independent dealers regardless of whether incumbent dealers could capture any rent reductions when transferring their stations.

<u>The Benefits of Act 257 to Current Dealers Will Not Likely be Fully Captured If the Lease rights are Transferred</u>

24. As a practical matter, any reductions in rent caused by Act 257 will not be fully capitalized in subsequent transfer prices by the current lessee dealers. This is because there are many unknown variables, e.g., forecasting future rent and the future level of gasoline margins and the sales of goods other than gasoline. Also, economically, any cost reductions from Act 257 will be fully captured by sellers only if the market for the sale of lessee dealer rights is perfectly competitive, and, in Hawaii, the low number of sales of dealer rights per year show such a thin market that certainly does not approximate a perfectly competitive market.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Honolulu, Hawaii; February 25, 2002.

/s/ Keith Leffler
KEITH LEFFLER

EXHIBIT 1

Keith E. Leffler
Curriculum Vitae

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California State University Northridge
BA. 1972 Economics
University of California Los Angeles
MA 1974 Economics Ph.D. 1977
Economics

Specialties: Industrial Organization
Antitrust Economics
Economics of Contracts

Academic Appointment: Associate Professor of Economics
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PAPERS, PUBLICATIONS, REPORTS AND PRESENTATIONS:

"Vertical Restraints After State Oil v. Khan," forthcoming, Washington State Bar Antitrust Newsletter, 1998

"Analysis of Gasoline Pricing in Arizona," report to the Arizona Attorney General's Office, 1998.

"The Competitive Impacts of ATM Surcharges," presented to the Washington State House and Senate Committees on Financial Institutions, 1997.

"Exclusive Dealing as a Facilitating Practice in Coordinated Oligopolistic Pricing," presented to the National Association of State Attorney Generals and the Antitrust Section of the Washington State Bar Association, 1996.

"The Economics of Presale Measurement: An Analysis of Presale Measurement in Competitive Timber Auctions," (with R. Rucker and I. Munn), presented to the Western Economic Association, University of Washington Working Paper, 1996.

"Competition in Gasoline-Markets," presented to the Washington State Senate Law and Justice Committee, 1994.

"The Use of Economics in Antitrust Proceedings", 1993, presented to the Antitrust Division of the Washington State Bar.

Information and Pharmaceutical Advertising", 1993, presented at the University of California Los Angeles.

"The Price Effects of Entry When Information Is Costly," 1992, presented at the University of Arizona.

"Private actions and Proof of Damages in Secondary Line Cases – The Texaco v. Hasbrouck Case," (with R. Whaley), Antitrust Law Journal volume 59, 1991.

"Transactions Costs and Economic Organization: A Study of Timber Harvesting Contracts," (with R. Rucker), Journal of Political Economy, October 1991, presented at Clemson University, the University of Chicago and Simon Fraser University.

"Prescription Drug Prices and Generic Entry: Bias in Measured Inflation," 1991, presented to the Conference on Pharmaceutical Economics, 1991.

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"Did the Federal Trade Commission's Advertising Substantiation Program Promote More Credible Advertising?" (with R Sauer), American Economic Review, March 1990.

"The Impact of the Iraqi invasion on Gasoline Prices," presented on The Compton Report, 1990.

"Franchising Contracts and the Protection of Information," 1989, presented to the Marketing Department, University of Washington.

"Multigood Pricing and Tie-In Sales," 1989, presented at North Carolina State University.

"The impact of the Exxon Valdez Spill on Gasoline Prices," 1989, Report for the Attorney Generals of Washington, Oregon and Idaho.

"Revenue from Public Natural Resource Sales: A Study of Timber Harvest Incentives," (with Rucker), Review of Economics and Statistics, May 1988.

"Duality Assurance in Retail Markets through Resale Price Maintenance," 1988, presented at the Department of Justice.

"Resale Price Maintenance and Retail Shelf Space Competition," 1987, presented at Washington University, St Louis.

"An Analysis of the Theory of Entry Deterrence;" 1987, presented to the Antitrust Section of the Washington State Bar.

"An Analysis of Gasoline Prices at Company Owned and Independently Owned Branded Stations," 1987, Report for the Washington State Legislature.

"Geographic Market Share: An Economist's Perspective of A Legal Quagmire," 1986, presented at the American Bar Association Meetings, San Francisco.

"Towards a Reasonable Rule of Reason," Journal of Law and Economics, May 1985, presented at the Hoover Institute, Stanford University.

"The Effects of the Advertising Substantiation Program on Advertising Agencies," (with R Sauer), in Regulation and Consumer Protection, presented to the Federal Trade Commission 1985.

"Analysis of the Alaska Pulp Company Antitrust Case," 1985, presented to the National Association of Attorney Generals.

"Arizona v. Maricopa County Medical Society: Maximum Price Agreements in Markets with Insured Buyers," Supreme Court Economic Review, 1983.

"Economic and Legal Analysis of Medical Ethics: The Case of Restrictions on Interprofessional Association," Law and Human Behavior, September 1983.

"Ambiguous Changes in Product Quality," American Economic Review, December 1982, presented at the American Economic Association, the University of Chicago, and Ohio State University.

"The Prohibition of Billboard Advertising: An Economic Analysis of Metromedia," Supreme Court Economic Review, 1982.

"Review of Regulating the Professions," editors Blair and Rubin, Journal of Political Economy, January 1982.

"The Role of Market Forces in Assuring Contractual Performance," (with B. Klein); Journal of Political Economy, January 1982, presented at the University of Rochester, the University of Chicago and the University of California at Los Angeles.

"Student Discount Rates, Consumption Loans and Subsidies to Professional Training, (with C. Lindsay), Journal of Human Resources, Summer 1981.

"Persuasion or Information? The Economics of Prescription Drug Advertising," The Journal of Law and Economics, April 1981, presented to the Western Economics Association.

"A Simple Model of Competitive Industry Equilibrium in New Product Research and Development," Economic Inquiry, January 1981.

"The ignored Issue in Economic Analysis of Minimum Wages," in The Economics of Legal Minimum Wages, 1981, presented to the American Enterprise Institute.

"Markets for Medical Care and Medical Education: An Integrated Long Run Structural Approach," (with C. Lindsay), Journal of Human Resources, Winter 1981, presented to the Southern Economics Association.

"Why Does Advertising Increase Demand?" presented to the American Advertising Association, 1980.

"The Economics of Product-Positioning", Journal of Business, August 1980, presented to Conference of Economics in Marketing, University of Rochester.

"Markets, Quality Uncertainty, and Professional Licensure," in Occupational Licensure and Regulation, 1980, presented to the American Enterprise Institute.

"The Competitive Effects of Advertising," Advertising Age, November 1980.

"Signaling: Efficiency and Equilibrium," (with J. Long and T. Russell), Economic Letters, Summer 1979.

"How Do Human Capital Investors Form Earnings Expectations?" (with C. Lindsay), Southern Economic Journal, October 1979.

"Do Physicians Create Demand?", Patient Care, May 1979.

Doctors' Fees and Health Care Costs," guest editorial, The Wall Street Journal, February 2, 1979.

Minimum Wages, Welfare and Wealth Transfers to the Poor," Journal of Law and Economics, October 1978.

"Government Output and International Income Comparisons," Journal of Monetary Economics, July 1978, presented at Carnegie Mellon University.

"Physician Licensure: Competition and Monopoly in American Medicine," Journal of Law and Economics, April 1978, presented at University of Rochester, the National Bureau of Economic Research, Purdue University, and the University of Chicago.

"Explanations in Search of Facts: A Critique of the Council of Wage and Price Stability Report on Physician Fees," Occasional Papers, Center for Law and Economics, University of Miami, 1979.

"The Market for Medical Care," (with C. Lindsay) in New Directions in Public Health Care, 1976.

WORK IN PROGRESS:

"Illinois Brick and Antitrust Damages"

"Transactions Costs and the Efficient Contract Structures in Oil Leasing."

PAST EDITORIAL POSITIONS:

Associate Editor, Review of Industrial Organization.

Associate Editor, Managerial Decision Economics.

GRANTS:

Earhardt Foundation, dissertation grant.

Robert Wood Johnson Foundation, grant to study competition in physician services markets.

Pfizer, Inc., fellowship to study competitive issues in the pharmaceutical industry.

Center for Research in Political Economy, grant to study public timber contracts.

Law and Economics Center, University of Miami, grant to study the pricing of physician services.

Pacific Institute, grant to study the effects of licensure on product quality.

American Enterprise Institute, grant to study the economics of advertising.

The Federal Trade Commission, grant to study the effect of advertising regulation.

US Department of Agriculture, grants to study timber contracts and oil leasing.

TEACHING:

Antitrust Economics, senior and graduate levels.

Microeconomic theory, beginning and graduate levels.

Industrial Organization, senior and graduate levels.

Continuing Legal Education Classes in Antitrust Economics, presented to the Washington State Attorney General's Office.

Antitrust economics lectures at the University of Washington Law School and Seattle University Law School.

MAJOR CONSULTING WORK:

MDL150 Coordinated Petroleum Products Litigation

Wilk, et.al. v. AMA, et.al.

FTC Investigation of the SOCAL – Gulf Oil merger

Hasbrouck v. Texaco

Coordinated Corrugated Container Antitrust Litigation

DES Market Share Reconstructions

U.S. v. Brown et.al.

FTC and DOJ Investigations of Microsoft

Infant Formula Antitrust Litigation

Rebel Oil v. ARCO

DOJ Investigation of the American Bar Association Law School Accreditation Policies

Brand Name Prescription Drug Antitrust Litigation

FTC v. Butterworth – Blodgett Hospitals

Washington, Oregon, California and Arizona investigation of Tosco-Unocal merger.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A., INC. Plaintiff, vs. BENJAMIN CAYETANO, et al., Defendants.	CV 97-00933 SOM Honolulu, Hawaii February 26, 2002 9:00 A.M. Non-Jury Trial

TRANSCRIPT OF NON-JURY TRIAL PROCEEDINGS
BEFORE THE HONORABLE SUSAN OKI MOLLWAY
UNITED STATES DISTRICT JUDGE

* * *

[9]Q I'd like to start by asking you some questions about your working relationship with Chevron and other oil companies in the past. You have testified in numerous depositions and in trials on behalf of Chevron and other oil companies; is that correct?

A Yes.

Q You've testified on behalf of Equilon before?

A In trial?

Q In a deposition or trial.

A Yes.

Q Equilon is a joint venture between Texaco and Shell and Star that was formed in 1998; is that correct?

A That's my understanding, yes.

Q And you testified on behalf of Equilon in a Los [10] Angeles case called Coast Village?

A Yes.

Q And that case involved a group of Shell lessee-dealers?

A Yes.

Q And the Shell lessee-dealers claim that Shell Equilon was trying to drive them out of business by raising their rent, among other things; correct?

A That was one of the claims, yes, uh-huh.

Q You were also retained on behalf of Equilon in a Houston lawsuit?

A Yes.

Q That suit was also against lessee-dealers?

A Against? I mean they were the ones who brought the claims.

Q Against Equilon; is that correct?

A They brought claims against Equilon. Let me think here. Try and remember if they named Shell and Equilon or Shell only. But one or more of the components of Equilon were involved there, yes.

Q In that Houston lawsuit generally the lessee-dealers were claiming that Shell or Equilon were treating them unfairly in some way; correct?

A Yes.

Q You've also testified on behalf of Shell in an [11] Indianapolis lawsuit; is that right?

A I don't believe my deposition was taken before it was settled. I had been retained by them to counsel them on the economic aspects of the argument.

Q And that was called the Becker Oil versus Shell case?

A Something like that, uh-huh.

Q And lessee-dealers had sued Shell in that case as well?

A Yes, uh-huh.

Q The lessee-dealers in that case against Shell claimed that Shell was trying to drive them out of business so that Shell could convert to company-operated stations. Wasn't that one of the allegations?

A That – to the best of my memory, yes, that was one of the allegations.

Q You were retained on behalf of a D.C. law firm in a case involving Cumberland Farms; is that right?

A That was 15 years ago. It could have been a Washington, D.C., law firm. I did some work for a firm related to some issues raised by Cumberland Farms, yes.

* * *

[14] Q I don't think that it does either. In that case, though, it was a case brought by lessee-dealers against Cumberland Farms.

A Probably. I think so, uh-huh.

Q And the lessee-dealers claim that Cumberland Farms unfairly raised the rent, didn't they.

A Sounds right, uh-huh.

* * *

[31] Q And your understanding is that Chevron today would prefer to build company-operated stations if it's a new ground-up $2 million facility; correct?

A It's my understanding that where – in those areas where Chevron would like to build that their preference would probably be more toward the company op, yes.

Q And company op as opposed to building and then leasing the station to a lessee-dealer.

A Yes.

Q And under those circumstances where Chevron has a company-owned station today Chevron controls the gasoline all the way from the refinery to the street.

A Is that a question?

Q Yes, sir.

A Yes.

* * *

[62] Q Dr. Leffler's final reason in paragraph 19 is that current and planned rents are generally below those allowed by Act 257, and, therefore, to paraphrase, it should mainly restrain substantial rent increases that might be designed to reduce or eliminate the dealer network, and this restraint simply has nothing to do with maintenance incentives.

First of all, do you have an understanding of what that means?

A Well, let me read it again.

Let's take the first statement. "Finally, the current and planned rents are generally below those allowed by Act 257." Well, the key word to look at there is the word "generally." In what I've seen of the financial documents in this case, on average Chevron's rents are relatively low and may in fact be below, on average, those [63] allowed by the law, but that's irrelevant to an economist. The question is at the margin are there any stations that are impacted, and the answer is again I've been told, and I've seen in the documents, that there are some Chevron stations that are currently charging a rent that is above what would be legally allowed. And it's the impact on those stations that we focus on in economics. So that's with respect to that first sentence.

"Therefore, Act 257 should mainly restrain substantial rent." Again "mainly," okay. You still have those stations that are at the margin impacted directly by the rent control. And for those stations it has nothing to do with whether you're going to have future increases in rent designed to reduce or eliminate the dealer network. That's just totally irrelevant. The question is those stations that are now impacted, there will be a disincentive to maintain those stations or to open new stations like them should the market move and relocate with population centers.

Q Okay. Before turning to paragraph 20 let me ask you a couple specific questions that were raised in your cross-examination. First of all, I think you said that Chevron typically owns the land under the lessee-dealer station.

A That was – I asked for qualification on that question [64] for that reason. Nationwide, if you look at Chevron's lessee-dealer network, for the most part the majority of them would be properties owned by Chevron. That's not true – that same observation does not apply in Hawai'i.

Q And what's the situation in Hawaii with respect to the land under the station?

A Now a much larger percent of the land underlying the lessee-dealer station is owned by somebody other than Chevron, and Chevron leases that land from a third party, puts the station on the land, and then leases it to a dealer.

Q Now, do you have an understanding – strike that.

As a matter of economics, when Chevron goes to renew or negotiate a renewal of that underlying ground lease for the station, do you have a view as to whether the rent control is going to affect Chevron's incentives in renegotiating or renewing the ground lease?

A Sure. If the rent control – if the rent control is truly effective, it will reduce the flow of money that Chevron gets from those stations. And by reducing the flow of revenue it reduces the profitability, it reduces the incentive to maintain that station, or in this case to renew the lease.

* * *

[92] Q And let's just go down to the State of Hawai'i, and for Chevron it shows what, about six company op?

A Yes. I think six.

Q It's a little illegible. Let's say six company op, 61 lessee-dealers.

[93] A Correct.

Q And six open dealers.

A Yes.

Q There's also some dealers that, instead of being supplied directly by one of the wholesalers, is supplied by a jobber, who is in between the wholesaler and the retailer.

A Yes. Typically on the outer islands; that's correct.

* * *

[96] Q And then you would take the company ops and Chevron has six out of a total of 300 stations.

A 2 percent.

Q So you'd say Chevron would have 2 percent, and you square that and that gives you 4 percent. And without going through the math for all the rest, by the time you add up all of these you end up with an HHI at the retail level of something very low.

A Probably 150.

Q And that falls into the highly competitive.

A Yes. It falls into the very unconcentrated level.

Q Okay. So at the retail level it's highly competitive or unconcentrated.

A Yes.

Q So it's your understanding that the legislature was concerned about high concentration at the wholesale level not about concentration at the retail level.

A Yes.

Q Because there's nothing to be concerned about from the concentration standpoint at the retail level.

A Certainly not at the current time.

* * *

[100] Q So, for example, if Chevron raises its DTW wholesale price to a dealer – to all of its dealers, let's say, on O'ahu, you would expect to see on average the dealers on O'ahu raising their retail price in reaction to the increase in the DTW.

A Yes.

* * *

[104] Q If somebody said to you Chevron is trying to drive its lessee-dealers out of business in Hawai'i by charging an excessive rent, you would say, "Not so. In fact, just the opposite."

A Well, I would say we'd have to examine it. That we [105] don't know. We have to look at the total payments in order to examine an issue like that.

It's as if I was renting you an apartment and I required you to get your cleaning services from me, and I was renting you a nice apartment here in Hawai'i for a hundred dollars a month but I was charging you a thousand dollars a week to have me clean the apartment. The hundred dollars wouldn't tell me anything yet without the understanding of the total payments required.

Q And for that reason, as you've said before, it's economically meaningless to look at rent without also considering gasoline revenues or vice versa.

A Certainly for the question you posed to me, yes.

* * *

[111] Q And that's because you think company-operated stations are more efficient than dealer stations.

A In today's gasoline retailing environment, yes, I think that's correct.

Q And over the years has it also been your observation that on average in general company-operated stations charge a lower retail price than lessee-dealer stations?

A Yes. Overall on average that's been my observation.

Q So, if you just take one market and all you want to do is have a lower average price, you would say the higher percentage of company-operated stations the lower the average retail price is going to be, just as a matter of arithmetic.

A Holding constant the DTW or holding constant the wholesale price, yes, company-operated stations tend to be able to operate under lower retail margins.

* * *

[114] Q I've gone back through those declarations and made a summary of the reasons that you gave in those declarations for high price levels at the wholesale level, the DTWs, and I'd just like to go down those – that list and, if you want to take a look at your prior declarations, if this doesn't ring a bell, I have copies here for you.

A Okay.

Q First of all, and this is a list of the reasons for the relatively high prices at the wholesale level.

A Okay.

Q Or at the retail level. Because in your view, as you've testified before, wholesale and retail prices go hand in hand.

A Yes.

Q Number 1, high taxes.

A Yes.

Q And those are taxes imposed by the federal government, the state government, and local governments.

A Well, the federal is universal throughout all the states; so all my comparisons would be area to area. So, [115] when I say high prices in Hawai'i, I mean high compared to other areas. So that would be – there are relatively high state taxes in Hawai'i on gasoline.

Q Number 2, high concentration at the wholesale level.

A Yes.

Q Meaning that there are six gasoline suppliers with market shares which, as we have seen, result in Herfindahl indices of 1800 or above.

A Yes.

Q Number 3, high entry barriers, meaning that without getting too precise about the definition there are impediments to new companies coming into the market.

A Yes.

Q And one way you have concluded that there are high entry barriers is otherwise additional companies would have entered the market given the profit opportunity reflected by the gasoline prices.

A Correct. The high prices couldn't be sustained if entry was easy.

Q And to list some or perhaps all of the entry barriers, one would be the substantial sunk costs and regulatory impediments for building new terminals.

A Yes.

Q Substantial sunk costs for providing retail outlets, the stations.

[116] A Yes.

Q And the market is already overbuilt with stations or oversupplied with stations.

A Yes.

Q And all of those factors make it more costly for a new company thinking about entering the market to actually do so.

A Correct.

Q You have advised Deputy Attorney General Ted Clause, who was the deputy in charge of investigating gasoline prices for the decade of the '90s, or for most of it at least, that there is one explanation for the high gasoline prices and margins, and that is that there are very few competitors and entry is relatively difficult. Correct?

A Yes.

Q It's also your view – and you've expressed this in sworn testimony – that the nature of the demand for various refined products here in Hawai'i contribute to the high prices in this sense: That the refineries must make a product slate tailored to the local market demand and there's a disproportionate amount of the low valued heavy fuel oil used by the utilities mainly, and that results in a higher cost for the more valued light products like gasoline.

A I'm afraid I have to phrase that one slightly [117] different. That is, in assessing whether or not the profits at the refining level are excessive, that needs to be taken account of. It doesn't really explain why – it has no independent value in explaining why the prices of particular products might be high.

Q Let me read this statement and see if you still agree with what you wrote back in 1997. "The relative isolation of Hawai'i requires these refineries to produce a product slate that is tailored to local demand." So far so good?

A Yes.

Q "This results in a disproportionate production of low valued heavy oils and a resulting high cost of the more valued light products, gasoline, diesel, and jet fuel."

A Yes, I agree with that.

Q It's also your view that in comparing markets the most significant factor in explaining low prices one plays relative to another is the presence of a reasonably-sized independent.

A There's certainly context in which that would be true. I don't know if I would agree with that as a general blanket statement in all context, but –

Q But where that's true it's true in part because independents tend to operate more through company-operated stations?

A No. It's because independents are – on average seem [118] to be less cooperative in small number situations.

Q They also offer a lesser package; right? They don't have typically credit cards, they don't typically have the location – the favorable locations for service stations that the major oil companies do?

A Yes. They tend to be price competitors. They focus on price.

Q And they tend to be lower priced.

A Yes.

Q So just from a matter of arithmetic the more and larger independents you have in a market the average price is going to be lower.

A Yes. Other things constant, yes.

Q And now I'm going beyond the reasons you've given before.

A Okay.

Q Would you agree that, if a location tends to have an antibusiness political climate, that tends to discourage new entrants. And let me give you an example because that's a pretty broad statement.

If a particular location controls the rents that an oil company can charge lessee-dealers, would you expect that that would be at least one factor a company would take into account in deciding whether to enter that market?

A Yes.

[119] Q You're aware that during the 1990s at various times the state legislature here considered bills to nationalize petroleum terminals.

A I'm only – the "nationalize" got me on that question.

Q To make them public.

A Okay.

Q To take them over from the oil companies.

A Yes.

Q And would you consider that as a factor that a new entrant would take into account in a negative way?

A Probably not in the context of Hawai'i because a new entrant has a real problem with terminal access; so from the view of an outsider they would view that as something that would allow them to enter more cheaply. In a more general broader context, I think a state taking action to, in effect, seize assets from a private company is not supportive of future entry.

Q And that's because, if you're a company thinking about entering the market and you know you're going to have to spend a lot of money, a sunk cost, if you will, to build a terminal with the prospect that that will be taken away from you, that would be a negative factor.

A Yes.

Q How about restrictions on building company-operated [120] stations close to the dealer locations that have already been taken?

A That is a factor that will generally raise the cost of entering or discourage entry.

Q And how about restrictions, just generally, on building the most efficient type of stations?

A Yes. Again, that would not be conducive to people viewing with favor entering into your market.

Q Now, none of those factors, except for the last ones about rent and so forth – let me strike that.

The factors you listed – taxes, high concentration at the wholesale level, high entry barriers, the refinery slate – none of those factors that contribute to higher prices depend on a claim that rent paid by lessee-dealers is too high; correct?

A Correct. Yes, I agree.

* * *

[121] Q So in the list of items that you have testified contribute to higher gasoline prices in Hawai'i would you agree that the rents being charged by Chevron to its lessee-dealers is not the problem? Is not the cause of high gasoline prices?

A Yes.

Q You'll agree with that.

A Yes.

* * *

[123] Q And with respect to lessee-dealers the decision on whether to build a new lessee-dealer station is a decision that's made by Chevron rather than a decision made by the dealer.

A Correct.

Q And so, if you're going to analyze whether new dealer stations are going to be built in the future, you look at the economics for Chevron.

A Correct.

* * *

[125] Q Your main contact with the state was Deputy Attorney General Ted Clause?

A Yes.

Q And you had a number of conversations and documents, memos, back and forth about whether or not that Act 257, in particular the rent control part, was going to be effective or whether it was going to be counterproductive with respect to gasoline prices; correct?

A Yes. We certainly had many extended discussions and exchanges concerning the possible impacts of the bill.

Q And at some point did Mr. Clause tell you whether or not he had advised that the governor veto the act because it would be ineffective or for some other reason?

A I don't know that I recall anything as strong as "advised to veto." I think that neither Mr. Clause nor I [126] thought it was a good bill in some large sense, but our focus was rather on what its impact might be in some particular dimensions.

Q Well, when you first looked at the rent control part of the bill, you thought that it would be ineffective because an oil company could simply raise the DTW price to make up for or to attempt to make up for the decrease in rent, based on your view that it's economically meaningless to look at rent without looking at gasoline and vice versa; correct?

A I don't recall that, but I may have. I certainly would be very cognizant of the fact that the analysis has to closely consider the various variables the oil company has to impact the dealers.

Q And your view was that, if the DTW or wholesale price increased to offset the rent reduction, then the bill would be doomed to be ineffective.

A If that was the effect, yes, I would agree.

Q And so you set about – strike that.

One of your early ideas was that somehow you needed to show that the rent control would combat the problems with the high concentration that the legislature was talking about.

A Yes. I certainly understood that in order for the control that was the subject of the bill to have any impact [127] on what the legislative preamble was saying was the problem that there had to be some nexus between the two.

Q But you also knew, as we've discussed, that changing the percentage of lessee-dealers and company-operated stations at the retail level was not going to effect wholesale gasoline prices.

A There's no direct impact. That's not to say that there can't be an indirect impact. And indeed I think the testimony describes what I concluded could be an indirect impact.

Q What I'm doing is going back to the start when you first started looking at this. And do you remember your declaration said maintaining the presence of lessee-dealers can serve the state's interest in limiting the extent of increased concentration and the impact of any increased concentration.

A In the original declaration?

Q Yes.

A I remember words to that effect, yes.

Q But then you realized that that argument concerned competition at the retail level, but that wasn't what the legislature was talking about.

A I'm having trouble only with – it sounds like I'm trying to recollect the thought processes as I was developing arguments, and I certainly don't have those [128] fresh in my mind.

MR. MITTELSTAEDT: Your Honor, I have the memorandum that I'd like to use just for purposes of refreshing the witness' declaration or –

THE COURT: Can you make sure you show that to counsel.

MR. MITTELSTAEDT: – recollection, I should say. May I approach?

THE COURT: Yes.

BY MR. MITTELSTAEDT:

Q We'll walk through that part of this. Do you recognize this is the form of a memo you sent to Mr. Clause –

A Yes.

Q – in March of 1998?

A Yes.

Q And you'll see in the first paragraph you say, "I've taken sections from the draft declaration and added some explanation."

A Yes.

Q And then in the first full paragraph you quote your draft declaration to the effect that I had just read the first part of.

A Yes.

Q Namely, that the presence of lessee-dealers limits the [129] extent of increased concentration and so forth.

A At the retail level, yes.

Q And then you say in the next paragraph, "This argument concerns competition at the retail level. We don't have any support available currently. Given the relatively small number of company-operated stations in Hawai'i, I don't think this is a very strong argument." You see that?

A Yes.

Q And that was your view at the time.

A Yes.

Q And then you say to get some support you need to look at a situation in which the number of stations was small such that adding to the company-operated numbers and lessening the number of independent dealers would cause a significant change in market structure. Do you see that?

A Yes, I do.

Q And you never analyzed that further or made an examination of such a situation, did you?

A No, I did not pursue effects at the retail level in and of themselves.

Q In the next paragraph you go on to what I call your monitoring argument.

A Okay.

Q Correct?

A Yes.

[130] Q And can we just take a second and work through this argument so it's clear. And I think there are a couple of steps to your argument. The first step is your view is that monitoring – and by monitoring (writing) you're talking about monitoring or detecting DTW price moves by looking at retail prices.

A Yes. Detecting changes in the wholesale price, and in this particular instance that would be the DTW.

Q So detecting changes in DTW from looking at retail prices.

A Yes.

Q And your view is that that is, if I can use a general noneconomic term, a bad thing because it facilitates cooperative or collusive pricing in an industry where there are few sellers.

A I'm a little hesitant to say bad, but, yes, I think the economic theory is pretty clear that transparency in pricing assists in cooperation and pricing. I wouldn't go as far as to use the word "collusion."

Q Instead of "bad" can I write "undesirable"?

A I try to stay away from a motive word such as that. Will lead to an increase in price or an expectation of a higher price.

Q Okay. And then the second part of your view is that you would like to do something or you think the legislature [131] should do something that makes it harder to detect DTW price changes.

A No. I mean I have never viewed my role in this at all as advising what the legislature should do.

Q Let me rephrase.

A Okay.

Q Your view is that, if you could show that the rent control made it more difficult to monitor or detect, that would be advancing a legitimate state interest.

A Yes.

A Given the preamble of the bill, it would be consistent with the nominal purpose of the bill to show that or to find that.

Q So you were looking for a way to show that the rent control bill would result in making it harder to monitor.

A I'm not sure "looking for" is the right word, but –

Q You were seeing if there was a way.

A I was looking for a connection between the rent control aspects of the bill and wholesale – high wholesale prices.

Q And, if you could find that rent control would make it harder to monitor, you would think of that as helpful to the state's case.

A Yes.

Q Your view is that the rent control will result in a [132] higher percentage of lessee-dealers, a greater number of lessee-dealers.

A No. No. My view is that the rent control will prevent or make more costly actions by the oil companies that would alter that mix. That is, the world is the way it is now, and I'm looking prospectively what might happen in the future.

Q Well, and your view is sometime in the future, if an oil company changes its present plan and decides to try and drive a dealer out of business by raising rents, then the rent control will prevent that.

A It will raise the cost of doing that. It will prevent it doing it via rent, yes, and thereby raise the cost of doing it.

Q And your view is at that time by raising the costs, making it more difficult to get rid of lessee-dealers, there

will be more lessee-dealers in the market than there otherwise would be.

A Yes.

Q So you're saying rent control – eventually, if an oil company does this, that, and the other thing, rent control (writing) leads to more lessee-dealers; right?

A First of all, I'd say rent "cap" not "control" because I'm concerned the situation where there's –

* * *

[133] THE WITNESS: And, secondly, that, as long as we're careful on our phrasing, you would be correct. It's not going to lead to more lessee-dealers. It's going to lead to more than otherwise would occur in a particular situation.

BY MR. MITTELSTAEDT:

Q Well, rent cap will lead to more lessee-dealers than without rent cap.

A In the situation where otherwise they would be reduced.

Q If oil companies come up with the plan to get rid of lessee-dealers by raising rent.

A Yes.

Q Now, so bottom line with all those conditions your theory is that what's good about rent control or the rent cap is that eventually in the future, if one thing or another happens, the rent control, the rent cap, will result in more lessee-dealers than otherwise would be the [134] case. And you say that's good because it will make monitoring more

difficult; companies will be unable to detect changes in DTW as well. Right?

A Well, again you're using the word "good" as if I'm doing some ethical evaluation of this process, rather –

Q Helpful to the state's case.

A Well, rather that there is a sound, reasonable economic theory in which the avowed purpose of the bill can be accomplished through the rent cap. And it is – the logic of it is I'm not sure exactly as you've outlined it but generally consistent with the outline you've offered.

* * *

[142] Q Was it also your view that, if the dealer tank wagon price was increased as a result of the rent control, then the retail price was also likely to increase? For the dealers?

A Yes. I'm sorry. I was just thinking of what you said. Yes.

Q And so it was your view that, if Chevron increased it its DTW because of the rent control, it would be awful hard to show any direct benefit to consumers because they would be paying a higher retail price.

A Well, it's an offset, certainly. I mean we'd have one factor leading to constraining prices that is more difficulty in cooperating at the wholesale level. Then we'd have another factor that's directly causing a price change in the upward direction. And it's kind of a balancing at that point.

Q You don't know where that comes out.

A No.

Q But, focusing on the retail price, when the DTW price increases, your view is the retail price increases; right?

A Yes.

* * *

[144] Q And your testimony in open court at least twice was that Chevron, presumably other oil companies, include rent in gasoline. And they can call it rent, they can call it gasoline, they can call it whatever they want, but between the rent and the gasoline they need to earn sufficient revenues to pay their costs plus a reasonable profit.

[145] A Yes. That they're charging the dealer for the right to occupy that station in two ways, just like my analogy of paying the rent for the apartment and then having to buy the cleaning. That that's part of the price you pay for occupying the station in this case.

* * *

[155] Q Okay. And in your declaration originally in this case you said that on average the dealers would capture that premium. Some would capture less, some would capture more, but on average they would capture the premium.

A I think, if it's not explicit, it's implicit.

Q Well, let me read from paragraph 16 of your declaration. "At best, we might expect the guesses of [156] potential buyers to be correct on average."

A Yes.

Q And then you say, "This implies half the purchasers would pay a premium less than the actual present value." And it was also true, isn't it, that the other half would pay more and so on average they would pay the premium.

A I think that's a fair expectation.

Q Now, in your written testimony, your direct testimony, you leave out the point about on average the dealers would pay the value of the premium. Or at least I didn't see it in there. Did you intend to exclude that on purpose?

A Not really. I thought that the important point here was that the Richardson analysis is irrelevant. And, therefore, the focus that I have in paragraphs 21 through 23 is to, I hope, carefully explain why it doesn't matter whether or not the incumbent dealers capture the premium for the analysis of whether or not the rent cap might affect high prices from high concentration.

Q And, if I can summarize your theory on that, your theory is that because paying the premium – when a new dealer pays the premium, that payment becomes a fixed cost rather than a variable cost.

A It's probably better to think of it as a sunk cost.

Q Sunk cost –

A Sunk. Gone.

[157] Q But it's also referred to as a sunk cost. That's a term you use?

A Sunk cost, yes.

Q So it converts it from a variable cost to a fixed cost or a sunk cost.

A Yes.

Q And your view is that at some time in the future, if the dealer falls on economic hard times, he will continue in business a little bit longer because he's only now looking at variable costs, and he's already paid the money for the premium in the past.

A Perhaps forever. I mean he will continue as long as the cash flow he's receiving from continued operation of the business exceeds the expenses he incurs because of continued operation of the business. And the premium is not a cost of continued operation of the business.

Q But you've also agreed that the relevant decision on whether a station is going to be built or whether the oil company is going to continue to use the station as a lessee-dealer station depends on the economics for the oil company.

A Yes.

Q And you agree that to the extent the dealers benefit from a rent cap with the premium or otherwise, that money goes into their pockets and comes out of Chevron's pocket.

[158] A Yes.

Q And reduces Chevron's incentive to build new lessee-dealer stations.

A Well, yes, the directional effect is clear. Yes, it reduces it.

* * *

[169] Q I see. Okay. And that establishes that in fact in Hawai'i at the relevant time the wholesale market was highly concentrated; correct?

[170] A Yes. It's just a quantification of a qualitative concentration notion.

Q Right. And, based upon the formula that is employed, the conclusion is that it's a highly concentrated market.

A Yes.

Q Down at the retail level, though, if you used the same HHI formula, what would the conclusion be? Would that be a highly concentrated market or not?

A No. As Mr. Mittelstaedt correctly noted there, it's highly competitive or unconcentrated.

Q Because there are many retailers at the retail level; is that correct?

A There are many independent individuals making decisions about retail price.

Q Okay. And that's the thing I wanted to clarify a little bit here. You are asked by Mr. Mittelstaedt about the numbers of retail stations, but indeed the question really is not only the numbers but the ownership type and kinds of retail station; is that correct?

A Yes. In calculating the concentration at retail, yes.

Q Because there are different kinds of retailers, are there not?

A Yes.

Q And that would be what?

A Well, as the letters indicate, generally lease [171] dealers, open dealers, and each of those tend to be an individual decision-maker. And then company-operated stations, which are a single decision-maker as a group.

Q And that's reflected by the, for example, at the top Chevron and a line directly down to the retail level.

A Yes. In some sense, if we think about Chevron and what's going on at retail, there would be 61 lease dealers each making pricing decisions, there would be six open dealers each making pricing decisions, and then Chevron making the pricing decisions as a single entity for the remaining six company-operated stations.

Q As opposed to just the numbers, why is the mix of retailers significant?

A Because the boxes we put them in are significant because two of those boxes are independent decision-makers, the lessee-dealers and the open dealers, and one of the boxes is a single decision-maker. So, for example, if we shifted – if we switched the 61 and the six for Chevron, making it six lessee-dealers and 61 company-operated stations, we would go from 62 decision-makers to seven decision-makers, even though we'd have the same number of stations in either case.

Q Just to simplify it for me, then, in other words, with respect to what's been referred to earlier as company ops or company-operated stations, then Chevron operates the [172] refinery at the top.

A Yes.

Q Chevron also is a wholesaler.

A Yes.

Q And, if Chevron also owns and operates the stations at the retail level, then that has a significant – that is significant.

A Well, what would happen is we would, in effect, mimic the structure that we have at the wholesale level at the retail level.

Q That's what you meant when you said the number of independent price setters at the retail level then would be affected.

A Yes.

Q Thank you. You know, you were asked about a country club earlier this morning. Do you remember that analogy?

A I do.

Q And you agreed that it was an analogy. I'd like to ask you whether it was a fair analogy or not in this context, the context we're discussing here today.

A Well, I don't think it's – it's not – it's an analogy of a rent control, but its not an analogy of what I believe is the substance and purpose of Act 257. That is, as I think in responding to Mr. Mittelstaedt, I kept emphasizing this is a rent cap as contrasted to a rent [173] control generally in substance. That is, it prevents something from happening that hasn't happened.

So the country club analogy, to me it would be similar to someone owns a country club and they are constrained

from converting it to some other use as long as there are people playing golf on it. And the golfers are concerned that this is going to be made into homes or something, and so they successfully get – or environmentalists are concerned. And there's a bill passed that says you can't increase the monthly dues above some level. That would perhaps cause no change in current rents, but it would prevent whoever owned that country club from taking an action, the result of which – the result of which was to basically make it unprofitable to golf at the country club, and now it can be converted to some other use. To me that would be the real analogy using a country club example.

* * *

[175] Q And you were asked as well, if the oil companies could not charge a market rent, that one alternative that it would have, if it could not recover their lost rent, would be to raise the DTW. Do you recall that?

A I think it was – the phrasing was a physical possibility or something along those lines.

Q Right. That's really the question that I want to ask because I want to try to ask it exactly the way it was asked of you.

I think the way the question was asked and posed to you was is there anything to stop Chevron from physically increasing the DTW – that is, the wholesale price of gasoline – if the rent is capped? And there was, I think, very careful selection of the word "physically." Do you recall that question?

[176] A Yes.

Q What about economically?

A It would serve – it would serve the oil companies' goal under the hypothesis of this question of increasing the amounts collected from the dealers to increase the DTW in lieu of a rent increase only if that meant they could make profit by increasing that DTW price. And, in fact, if an oil company – I mean I believe that oil companies' behavior is best explained by assuming they take actions to maximize the value of their assets or more simply just to maximize their profits. So the economic constraint is that an oil company in setting its DTW prices will have taken account of how the market reacts, how its competitors react, supply and demand conditions, and it will be setting a price that it believes is the price that does the best for the company, that makes it the most money. And, therefore, the economic constraint on it, yes, it could certainly raise the price, charge the dealers. If it does it, it's going to sell less gasoline, and the issue is would it make more money. Well, if it would have made more money raising the price, it would have raised the price.

So the economic constraint is it wouldn't do it because it wouldn't be profitable. So, yes, it could physically do it, but it would not do it.

* * *

[182] Q I'm not talking about the articles. I'm talking about standard economic theory that an oil company has less incentive to invest in lessee-dealer stations if the rent's controlled.

A Yes. I do not dispute that today. I agree with that – I not only agreed at my deposition, I agree with it today. The directional effect is certainly in that direction.

* * *

[185] But, if the oil companies in fact are receiving, as rent, less than what it [186] costs to build and maintain the stations, it could have raised the DTW or the wholesale price of gasoline before Act 257; correct?

A Yes.

Q But it did not, did it.

A No.

Q Why not?

A I presume the answer is because it thought that the price it was charging, given the competitive situations in the marketplace, was the best price that it could charge.

Q The optimal price for DTW or the wholesale price of gasoline that could be charged in the marketplace at any given time.

A Yes.

MR. KOSHIBA: Thank you.

FURTHER RECROSS EXAMINATION

BY MR. MITTELSTAEDT:

Q In the stipulation of facts, number 23 says, "In the aggregate Chevron has not within the last 20 years recovered its expenses relating to dealer stations, ground lease rents, real property taxes, ordinary maintenance and depreciation in Hawai'i or elsewhere in the United States from dealer station rents."

You don't dispute that, do you?

A No, I do not dispute that. I'm just looking for the [187] stipulation I was referring to, which is talking about its overall recovery at its stations.

Q Do you want to find that?

A Sure. Just give me a second here.

A Stipulation 21, I think, implies that.

Q Okay. And 21 says that, "Including the earnings from gasoline – and you agree they need to be included.

A Yes.

Q "Chevron has earned in the past a return that satisfies constitutional standards on investment."

A And anticipates it will earn in the future at levels allowed by Act 257.

Q So you were asked questions about, if Chevron's rent is less than needed to recover its expenses, why doesn't it increase the gasoline price. And isn't it your view that the gasoline price is what it is –

A Yes.

Q – in part because it does include rent. In other words, it includes some portion to help offset the reduction or the fact that the rent doesn't cover expenses.

A Well, I don't think the "because" is proper. It's not what it is because of that, but it is what it is because Chevron in my opinion is setting the price that Chevron thinks is the most profitable price to set, and it turns out that that price is sufficient to cover all its [188] expenses.

Q But, as you look at it, Chevron gets rent from dealers that's insufficient to cover expenses, and it charges gasoline price that helps make up for the lower, relatively speaking, rent.

A I could almost say – go the other way. I could say, well, it charges low rent so it gets people to run these stations, and then it makes a lot of money selling them gasoline. But it's really artificial to separate them in the context of assessing the profitability of the stations.

Q Because, when Chevron sets one or the other or both, it looks at the overall profitability; correct?

A Yes.

Q And you have testified in other cases that the DTW includes rent, in quotes, in that it helps offset the lower than market rents that Chevron charges.

A No. I mean I have testified that it includes rent but not in the sense you said. I've testified it includes rent because it is a charge made – it requires direct supply. The dealer can get the gas cheaper. They're forced to buy the cleaning surfaces in the apartment context from the landlord at a price hi[illegible]her than otherwise available to them, and in that sense it's a charge for the right to occupy the real estate, i.e., economically, that's what we mean by rent.

[189] Q Whether you call it rent or DTW, it all is just money and it adds up to what Chevron thinks the optimal overall price to the dealer is. In my example before, a dollar four; correct?

A It adds up to, yes, the best Chevron can do in dealing with its dealers.

Q Now, if Chevron is required to reduce one component or another, does that change Chevron's view of the optimal amount of money it can get from a dealer or it wants to get from a dealer?

A Yes, it does. It reduces it. It wants to get – it doesn't want to get a hundred and four. It wants to get a million. It wants to get as much as it can. It's able to get a dollar four, and we say you're not able to get a dollar four anymore because we're not going to allow you to charge the old rent. It now can't get a dollar four anymore. So the new optimal is something different: a dollar two.

Q The person within Chevron who says, "All I know is the market let's me get a dollar four from the dealer," that person who doesn't care about whether it's rent or gasoline may still think to himself I want to get a dollar four.

A He may. He won't have a job real long, but he may.

Q Well, if an oil company has a choice of losing the two cents a gallon on rent and not recouping it at all or the [190] other choice is to try and recoup some of it in gasoline, even if the volume's going to decrease somewhat, a person might decide it's better to try and recoup some of it than to lose the two cents a gallon.

A But to say –

Q Could you just answer that. A person could reasonably say that.

A No, he couldn't reasonably say that because to say that says that I would have made more money selling gasoline at a higher price than I was currently charging. And why wouldn't they do that?

Q Because the rent they were charging was the four cents and it was the total package that the dealer was looking at or the market was looking at. But let me ask you this. If you're right on that point, then Chevron bears the full burden of the rent cap or the rent control.

A Yes.

Q And that in turn leads to a disincentive to invest in lessee-dealer stations; correct?

A Yes.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

CHEVRON U S.A., INC.	)	CV 97-00933 SOM
Plaintiff,	)	Honolulu, Hawaii
vs.	)	March 25, 2002
	)	9:45 A.M.
BENJAMIN CAYETANO, et al.,	)	Further Hearing
Defendants.	)	

TRANSCRIPT OF NON-JURY TRIAL PROCEEDINGS
BEFORE THE HONORABLE SUSAN OKI MOLLWAY
UNITED STATES DISTRICT JUDGE

* * *

[6] THE WITNESS: Basically, because of the law of demand. When a DTW goes up, the dealers have the incentive to raise the retail price. And, when they raise the retail price, some of their customers will either buy less gasoline or actually leave and go to other gas stations where they buy their gasoline. And so the law of demand puts an upper limit on how much the oil companies can recoup by simply raising the wholesale price.

* * *

[8] THE COURT: Then why wouldn't Chevron raise the wholesale price for those stations to completely offset the rent reduction?

THE WITNESS: Well, they would certainly try. And your question – the reason – they would try to raise the wholesale price to recoup as much of the lost rent as they could, and the law of demand operating at each of those individual stations, however, is going to limit the

total amount they're able to recoup. In other words, at the stations where they raise the price those stations will have a reduction in the volume of gasoline they sell if the dealer raises his retail prices, which logically he would.

THE COURT: Then, if the offset is not total, mightn't consumers in deed benefit from Act 257 because, if the increase in the wholesale price is less than the decrease in the rent, then the lessee dealer's overall cost would go down.

THE WITNESS: No, no. The dealer's overall revenues are going to fall because he's going to be selling less gasoline. It's just that – here's another way to say it. At the individual stations that are affected there's going to be less revenue generated in total from gasoline sales because they're going to lose some customers. And so, even if the oil company doesn't recover all of the rent reduction, that does not mean the dealer is going to [9] benefit because the whole revenue stream is smaller. In fact, in all likelihood both the dealer would lose and the oil company would lose. They're both going – because they've optimized already the combination of rent and wholesale prices that they've chosen. So any deviation from that optimization is going to mean a smaller pie for the dealer and the oil company to divide among themselves.

THE COURT: I'm sure I'm missing something here, but, if the rent goes down, then can't the money that the dealer saves by paying lower rent go toward paying the higher price of gasoline that you've posited so that he would not have to reduce the volume of gasoline that he buys?

THE WITNESS: No. Yeah, you are missing something. And, unfortunately, it's a fairly subtle point,

but, interestingly enough, it's one in which both Dr. Leffler and I agree upon.

And it's the difference in the treatment of rent as what we call a fixed cost and the DTW, which is what we call a variable cost. The reduction in rent by itself – let's suppose the oil companies do not raise their DTW for a second and they just lower the rent to the dealer. There is no reason in our economic theory to believe that the retail prices would fall. That is, the dealer would just pocket the difference. Okay?

[10] THE COURT: Why is that?

THE WITNESS: Why is that?

THE COURT: Why do you say that?

THE WITNESS: Why do I say that.

THE COURT: I know that was in the argument that Chevron or somebody submitted, but I didn't remember any opinion on that during trial.

THE WITNESS: It's actually an opinion shared by Dr. Leffler and myself and all economics text books. And that is that a fixed commitment to pay dollars each month in the form of rent does not affect the decision on how much gasoline to sell or what price to charge at the retail pump. But, when the wholesale price goes up, then the incentive for the dealer to reduce his volume in order to save some of those variable costs will lead him to raise the retail price.

* * *

[11] Q The question is just this. Dr. Umbeck, at page 2 of the state's post-trial brief they say that, "The purpose

of the rent cap is not to directly pass rental savings from the dealer to the consumer. Both economists agree that, as a matter of economic principle, this will not happen." And then they say, "If the dealer has more money in his pocket, it is not expected that he will hand it to the consumer in the form of lower prices."

And my question is to the extent the dealer has [12] more money in his pocket because his rent has been lowered do you agree with that statement? That he is not expected to hand it to the consumer in the form of lower prices?

A Yes. That's basically what I've been saying. When the oil companies by under this rule are required to lower their rent, it just puts money in the dealer's hand. And there's no reason for him to pass that on in the form of lower prices to the retail customer.

However, when the DTW is raised, then he has an incentive to raise his retail price, and that's where you get the volume effect, and that's why the size of the total pie divided by the oil company and the dealer will be smaller. And they both actually are worse off as a result of the change in the mix of rent and DTW.

* * *

[13] Q Dr. Leffler, I understood Dr. Umbeck to say that the law of demand puts an upper limit on how high the DTW price increase could go. Did you generally understand him to be suggesting that there is a limit to the law of demand?

A It's not – it's not that there's a limit. In fact, rather that the law of demand constrains what the best price is. And that has been operative with or without the Act 257

so that my disagreement with Dr. Umbeck is the whole notion that the reaction to a reduction in rent by the oil companies will be an attempt, in quotes, to recoup the amount they lost. If the oil companies could make more money through the pricing of gasoline, they will do that. They will do that whether they can charge lots of rent or no rent. That is, they maximize the profit they can earn [14] from the sale of gasoline.

And so in no sense at all are they setting those prices to recoup anything, and the fact that you change the amount they collected for rent doesn't change at all their pricing incentive with respect to gasoline. So the law of demand is what determined the original price of gasoline. It is still as operative independent of the implementation of Act 257. So that in that regard is my disagreement.

* * *

[15] Q Dr. Umbeck, do you agree with Dr. Leffler's answer about there will be no effect on the DTW price from rent control?

A No. Absolutely not. And the reason is that the DTW is optimized but always subject to the rent that's currently being charged. In other words, when you're charging the dealer, let's say, $5,000 a month rent, you can continue to raise the DTW until you reach some optimum where the DTW generates revenue for the oil company plus the rent revenue that's generated that's at a maximum. Now, when you lower the rent, you allow or make it less costly for the oil company to raise the DTW. And so just given again the basic law of demand it's less costly to raise DTW; therefore, you're more likely to raise it.

So I disagree completely with Dr. Leffler on this one basic point. Oil companies do optimize their DTW, but, when you change the rent, you change the optimization solution, and the DTW will indeed rise to offset partially the added – the loss of revenue from the rent control.

* * *

UNITED STATES DISTRICT COURT

DISTRICT OF HAWAII

CHEVRON U.S.A., INC.

Plaintiff(s),

V.

BENJAMIN J. CAYETANO, et al

Defendant(s).

JUDGMENT IN A CIVIL CASE

Case: CIVIL 97-00933 SOM

FILED IN THE
UNITED STATES DISTRICT COURT
DISTRICT OF HAWAII

March 29, 2002

At 4 o'clock and 00 min p.m.
WALTER A.Y.H. CHINN, CLERK

[ ] **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

[✓] **Decision by Court.** This action came for consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that Judgment is entered in favor of Chevron pursuant to "Findings of Fact, Conclusions of Law, and Order" filed on March 29, 2002.

cc: all counsel

March 29, 2002
Date

WALTER A.Y.H. CHINN
Clerk

/s/ Barbara Yamada
(By) Deputy Clerk

(22)

No. 04-163

Supreme Court, U.S.
FILED
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In The
Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate and enjoin state economic legislation on the basis that the law effects a "taking" because it does not "substantially advance a legitimate state interest," without regard to whether the challenged legislation diminishes the economic value or usefulness of any property.

2. Whether, even if applicable in takings analysis, the "substantially advance a legitimate state interest" inquiry authorizes a court to conduct a *de novo* trial to determine if challenged legislation will achieve its goals, or whether the court should instead apply a deferential standard of review equivalent to that traditionally applied in reviewing economic legislation under the Due Process and Equal Protection Clauses.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings below were petitioners Linda Lingle, the Governor of Hawaii, and Mark J. Bennett, the Attorney General of Hawaii, and respondent Chevron USA, Inc. Pursuant to Fed. R. App. P. 43(c)(2), Linda Lingle was substituted below for her predecessor as Governor, Benjamin J. Cayetano, and Mark J. Bennett was substituted below for his predecessors as Attorney General, Earl I. Anzai and Margery S. Bronster. (The opinion of the Ninth Circuit issued on April 1, 2004 erroneously listed former Attorney General Bronster as a defendant; the court amended its opinion on April 15, 2004 to correct the caption.)

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OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. 1) is reported at 363 F.3d 846. The opinion of the District Court (Pet. App. 30) is reported at 198 F. Supp. 2d 1182. A prior decision of the Court of Appeals, reversing summary judgment and remanding for trial (Pet. App. 54), is reported at 224 F.3d 1030. The District Court's initial decision granting summary judgment (Pet. App. 94) is reported at 57 F. Supp. 2d 1003.

JURISDICTION

The Court of Appeals entered its judgment on April 1, 2004. On June 21, 2004, Justice O'Connor extended the time to file a petition for certiorari to July 30, 2004, and the petition was filed on that date. This Court granted the petition on October 12, 2004. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED

The Fifth Amendment to the Constitution provides in relevant part: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." The Fourteenth Amendment provides, in Section 1: "No state shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." The relevant portions of Act 257, Haw. Rev. Stat. § 486H-10.4 (1997), are reprinted in the appendix to this brief.

STATEMENT OF THE CASE

1. This case involves a challenge to legislation enacted by the State of Hawaii to forestall the evils of

oligopolistic concentration in the retail market for gasoline in this State. Hawaii, which is "physically small and geographically remote," is subject to high levels of concentration in certain markets, leading to prices above competitive levels that harm Hawaii's consumers. Act 257, § 1(4), App. 1-2. The wholesale markets for oil and oil products in particular are highly concentrated, JA 139, adversely affecting an industry of "vital importance" to the welfare of Hawaii's people. Act 257, §§ 1(1), (5), App. 1-2. Hawaii is served by only two refiners; the larger of those refiners, Chevron USA, Inc., controlled 60% of the market share for gasoline produced or refined in Hawaii in 1997. JA 43. The wholesale market for gasoline on Oahu, the state's most populous island, is divided among only six companies, with respondent Chevron holding 30% of the wholesale market. JA 43-44.

Until now, the retail market for gasoline has been protected from similar high concentration by the presence of numerous independent gas station operators. These operators set pump prices independently and in competition with one another, as well as with other stations operated by the oil companies themselves and staffed with company employees. JA 95-96. In a typical lessee-dealer arrangement, such as those employed by Chevron in Hawaii, the oil company purchases or leases land, builds a service station, and leases the land and facilities to a dealer. The oil company charges the lessee-dealer a monthly lease rent, usually defined as a percentage of sales of gasoline and sometimes other goods, and also requires the dealer to enter into a supply contract with the oil company, under which the dealer commits to purchase motor fuels from the oil company for resale to the public at a wholesale price unilaterally set by the oil company. JA 37-38.

Act 257 was enacted to maintain the benefit for consumers of a multiplicity of independent lessee-dealerships that set retail prices on a competitive basis.

The Act accomplishes that objective by preventing oil companies from converting independent stations to company-operated stations.[1] Replacing a prior law that broadly prohibited oil companies from directly operating gas stations, *see* App. 5-6, the Act takes a multi-pronged approach to forestall concentration in the retail market for gasoline. Section 3(a) of the Act prohibits oil companies from converting existing lessee-dealer stations to company-operated stations. Section 3(b) of the Act further protects lessee-dealers from economic pressure from oil companies by prohibiting oil companies from locating new company-operated stations within close proximity to a dealer-operated service station. Finally, to address the possibility that oil companies might try to accomplish such conversion indirectly by raising rents to the point that existing dealers would be forced out of business, Section 3(c) of the Act, at issue in this litigation, limits the maximum rent that oil companies may charge dealers. Section 3(c) limits the rent that an oil company may charge a lessee-dealer to 15% of the gross profit from the dealer's sale of motor fuel and 15% of the dealer's other gross sales. App. 2-3.

---

[1] Because oil companies perceive company-operated stations as more profitable, JA 115, 120, oil companies have an economic incentive to replace leased stations with company-operated stations. Congress has repeatedly found that oil companies have engaged in anticompetitive practices toward independent retailers by, for example, imposing "massive" rent increases in order to force surrender of the dealers' leases. *See, e.g.*, S. REP. NO. 102-450, at 3-4, 6 (1992) (Senate Comm. on Judiciary). Concerns over such practices led Congress to enact the Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-2806 ("PMPA"), which bars oil companies from directly converting leased stations to company-operated stations. *See* 15 U.S.C. § 2802. The PMPA does not explicitly control rent increases, however, and dealers have often failed in the difficult task of showing that allegedly predatory rent increases violated the PMPA. *See, e.g., Duff v. Marathon Petroleum Co.*, 51 F.3d 741 (7th Cir. 1995). *See generally*, Brief for the Service Station Dealers of America as Amicus Curiae.

Although Act 257 employs rent regulation to achieve its goals, it was not enacted primarily for the benefit of dealers paying rent (in contrast to, for example, an apartment rent control measure intended primarily for the benefit of rent-paying tenants). Rather, the Act seeks to stabilize the present structure of the retail market for gasoline, preserving the long-term benefit for consumers of multiple retail vendors and averting the economic harm that would occur if the retail market, like the wholesale market, were to become concentrated in the hands of the few oil companies serving the islands.[2]

2. Chevron USA, Inc., the largest refiner and marketer of gasoline in Hawaii, sued the Governor and Attorney General of Hawaii in district court under 42 U.S.C. § 1983, claiming that the rent cap imposed by Act 257 on its face effects an unconstitutional taking of Chevron's property and violates due process and equal protection. Chevron sought declaratory and injunctive relief, but did not request compensation. JA 5-20.

Chevron subsequently stipulated that the cap on permissible rent established by Act 257 limits its collection of rent at only 11 of the company's 64 lessee-dealer stations; at Chevron's other 53 stations, Act 257 permits Chevron to collect more rent than it would otherwise seek to charge. JA 37, 45-47. Chevron in fact recovers more rent in aggregate from its leased stations under Act 257 than it otherwise would have charged under its own rental program, and the Act allows Chevron to raise its aggregate rental income by as much as $1.1 million if it chooses. JA 47.

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[2] In the same time period as it enacted Act 257, the State initiated antitrust litigation, later settled, against the oil companies serving the state. *See Anzai v. Chevron Corp. et al.*, Civ. No. 98-00792-SPK (D. Haw.).

As is customary in this industry, the rent that Chevron charges its lessee-dealers (under Act 257 or otherwise) does not fully cover its projected expenses for its dealer stations; rather, Chevron also looks to earnings from gasoline sales to provide an income stream to make its dealer station operations profitable. JA 38-39. Thus, Chevron stipulated that it "has not within the last 20 years recovered its expenses relating to dealer stations . . . in Hawaii or elsewhere in the United States from dealer station rents." JA 40. Chevron also stipulated that, including its earnings from gasoline sales, "Chevron has earned in the past and anticipates that it will earn in the future, at the rent levels allowed by Act 257, a return that satisfies any Constitutional standards on its investment in lessee dealer stations in Hawaii." *Id.*

In 1998, the District Court granted Chevron summary judgment on its claim that § 3(c) of Act 257 effects a taking of its property, and enjoined enforcement of the statutory rent cap. In reaching that conclusion, the District Court did not conclude that Act 257 had physically appropriated any property of Chevron, that Chevron had been denied any of the essential aspects of the "bundle of sticks" making up its property rights, or that Chevron had been denied the economically beneficial use of its property. Rather, relying on language from this Court's decision in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), the court held that the rent cap in Act 257 constitutes a taking because it "does not substantially advance legitimate state interests." Pet. App. 118. The court also rejected the State's argument that, in adjudicating the taking claim, it should employ a deferential standard of review similar to that applied in the review of economic legislation under the Due Process Clause. Pet. App. 103-06. Chevron then voluntarily dismissed its due process and equal protection claims without prejudice.

3. On appeal, the Ninth Circuit held that the District Court applied a correct standard of review under the Just

Compensation Clause, but vacated the grant of summary judgment and remanded for trial. The court read a previous circuit decision, *Richardson v. City and County of Honolulu*, 124 F.3d 1150 (9th Cir. 1997), to foreclose the State's argument that a deferential, rational-basis standard of review should apply. Rather, the court stated that "a challenged regulatory action 'substantially advances' its interest if it bears a reasonable relationship to that interest," and concluded that "[w]hether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on whether it will in fact lead to lower fuel prices." Pet. App. 76.

Finding that the expert affidavits before the trial court did not resolve that question, the Court of Appeals directed the District Court on remand to use trial procedures, including assessment of the credibility of the parties' expert witnesses through cross-examination, to determine as a matter of "predictive fact" whether the statute will achieve its goals. Pet. App. 69-72. The majority directed the District Court to focus in particular on two questions that it viewed as going to the effectiveness of Act 257: whether dealers could recover a "premium," representing the economic value of the rent cap, if they sublease their stations, and whether Chevron could recoup any lost rent under the new law simply by raising its wholesale prices for gasoline sold to its dealers. Pet. App. 69. The majority rejected, however, Chevron's alternative argument that Act 257 was a taking because it deprived the company of economically viable use of its property. The majority noted that the Act permits Chevron to recover approximately $1.1 million more in rent than it would otherwise have charged. Pet. App. 77.

Judge William Fletcher concurred in the Ninth Circuit's reversal of summary judgment for Chevron, but disagreed with the majority regarding the applicable legal standard. Judge Fletcher contended that this Court's precedents require that rent controls and other price

controls be evaluated under a deferential standard of review, rather than the heightened "substantially advance" standard employed by the majority. Pet. App. 79-93.

4. On remand, the District Court held a one-day evidentiary hearing at which the parties each presented a single expert economist to give his opinion on the effectiveness of Act 257's rent cap in protecting Hawaii's consumers. Chevron's expert, Professor John Umbeck, argued that dealers will be able to capture a premium reflecting the economic benefit of the rent cap if they sublease their stations to new dealers, making the law ineffectual to the extent it aims at lowering dealer costs. He also opined that oil companies will try to recoup at least part of any lost rent by increasing the wholesale gasoline prices charged to their dealers, undermining the goal of controlling gasoline prices. Finally, Professor Umbeck argued that the rent cap will discourage oil companies from investing in new lessee-dealer stations, leading over time to fewer such stations. JA 48-65. Professor Umbeck did not deny, however, that the law will prevent oil companies from using rent increases to displace lessee-dealers.

The State's expert, Professor Keith Leffler, testified that, by helping to maintain the existence of lessee-dealers as independent price-setters, Act 257 protects Hawaii's consumers from the economic harm that would result if the retail gasoline market were controlled directly by a few oil companies. He also testified that the legislation will achieve this goal whether or not existing dealers could capture a premium upon subleasing, because the rent cap will in any case preclude the oil companies from raising rents to the point of driving dealers out of business. Professor Leffler rejected Chevron's contention that the oil companies will attempt to raise wholesale prices; given that Chevron's wholesale prices are presumably already set to maximize net revenue, fundamental economic principles teach that any increase in prices would lead to a

reduction in net revenues from reduced sales volume. He also disputed Chevron's suggestion that the rent cap will deter the oil companies from investing in new lessee-dealer stations, and opined that the legislation will benefit consumers as long as some lessee-dealers remained in the retail market. JA 91-103.

After searching in vain for demeanor evidence that might help establish the witnesses' credibility, Pet. App. 43, the District Court concluded that the economic theories presented by Chevron's expert were "more persuasive" than those of the State's expert. *Id.* The District Court therefore concluded that Act 257 does not "substantially advance a legitimate state interest," and thus effects a taking of Chevron's property. Pet. App. 53. The District Court acknowledged that the rent cap would prevent oil companies from raising rents to levels designed to drive lessee-dealers out of business, but it discounted this justification for the Act because it did not believe that oil companies would attempt such constructive eviction. Pet. App. 48, 52.[3]

5. On appeal once more to the Ninth Circuit, the State argued that Chevron's claim that Act 257 does not "substantially advance a legitimate state interest" lies under the Due Process Clause, rather than the Just Compensation Clause. The State also argued that, whatever the constitutional basis for Chevron's challenge, the District Court should have deferred to the rational economic

[3] The District Court overlooked testimony in the trial record that oil companies preferred direct operation of gasoline stations, JA 115, as well as the testimony of Chevron's own expert that he had served as an expert witness for oil companies in many cases where dealers alleged that oil companies had raised their rents in order to drive them out of business. JA 112-15. As noted, *supra* n.1, Congress has explicitly recognized that oil companies engage in anticompetitive practices toward independent dealers, including attempting to evict them through "massive" rent increases.

judgment of the legislature that the rent cap will benefit consumers. The Court of Appeals held that these arguments were barred by the law of the case established in its previous decision. Pet. App. 5. The Ninth Circuit noted that the "varying opinions" of the Supreme Court "suggest confusion over the relationship between due process and takings claims," Pet. App. 10, but concluded that this Court had not clearly repudiated the "substantially advance" takings formulation, and held that its prior decision applying this formulation was not clearly erroneous. Pet. App. 11-13. The Court of Appeals also concluded that it had not erred in requiring a heightened, "intermediate" standard of review under this takings theory. Pet. App. 14-17.

Applying heightened scrutiny, the Court of Appeals affirmed the District Court's conclusion that the rent cap imposed under Act 257 does not substantially advance a legitimate state interest. In reaching that conclusion, the Court affirmed, under the clearly-erroneous standard, findings of the District Court purporting to conclude that the law would fail to have the effect of reducing gasoline prices.[4] Pet. App. 21. The Court did not address whether

[4] The Court of Appeals rejected the State's contention, however, that the District Court's finding that Act 257 will prevent constructive eviction of lessee-dealers established that the law substantially advances the State's goals, even under a heightened standard of review. In reaching that conclusion, the Court of Appeals misapprehended the purpose of Act 257. The Court of Appeals suggested that the purpose of the law was to *reduce current* retail prices for gasoline, not – as the State had maintained – to *preserve* the current, relatively unconcentrated structure of the retail gasoline market. Pet. App. 18. The State did not contend, however, that Act 257 would have the effect of directly reducing current gasoline prices; rather, it argued that, by maintaining the viability of lessee-dealers, the Act will prevent future harm, in the form of increased gasoline prices, that would result if independent retail gasoline vendors were eliminated. Protection of the lessee-dealers is thus a means to avoid the economic harm of oligopolistic concentration in the retail market for gasoline. Testimony by the State's expert,

(Continued on following page)

the rent cap would survive the traditionally deferential rational-basis review of economic legislation.

Judge Fletcher dissented, repeating his view that the "substantially advance" takings test was incorrectly applied to the rent cap imposed by Act 257:

> We took a wrong turn in *Richardson*, we continued on the wrong path in *Chevron I*, and we are now in the wrong place. Under the panel's holding, virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and many of those laws may well be held unconstitutional under that test. Rent control is often inefficient and sometimes unfair. But we should not confuse inefficiency and unfairness with unconstitutionality.

Pet. App. 29 (internal quotes and citations omitted).

SUMMARY OF ARGUMENT

I. Relying on language in this Court's decision in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), the Court of Appeals concluded that general economic regulatory legislation can be held to effect a "taking" of property if it does not "substantially advance legitimate state

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quoted by the Ninth Circuit, makes the prophylactic nature of the act clear: "The lease rent cap imposed by Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline markets in Hawaii by maintaining the viability of independent dealers and thereby benefit consumers by reducing gasoline prices *below what they would be otherwise*." JA 94, quoted at Pet. App. 19 (emphasis added). *See also* JA 97 (predicting an increase in gasoline prices if lessee dealers were no longer an active anticompetitive force in Hawaii gasoline market); JA 100 (impact of Act is not to benefit dealers immediately but to prevent *future* actions injuring the dealers); JA 133-35 (describing effect of law as leading to more lessee-dealers in the market than would be the case if the oil companies tried to replace them).

interests." This ruling is mistaken because the "substantially advance" inquiry represents a due process test, not a test for a taking under the Just Compensation Clause.

A. The ruling below that a law may effect a taking because it fails to advance a legitimate purpose is inconsistent with basic principles of takings jurisprudence. Because regulatory takings doctrine rests on the analogy between government actions that severely restrict the use of private property and government actions that directly appropriate private property, an essential focus of this Court's regulatory takings analysis has always been the economic impact of regulation. The "substantially advance" test addresses only the *effectiveness* of government action, however, and disregards economic impact altogether. This test, which asks whether the government's action is invalid and must be rescinded, contradicts the settled understanding that the primary purpose of the Just Compensation Clause is not to restrict government from appropriating property, but rather to require compensation for such appropriations. In suggesting that a government action may be a taking *because* it is illegitimate, the "substantially advance" theory also conflicts with the basic understanding that the valid exercise of the government's taking power *depends* on its serving a legitimate "public use." Finally, the incongruity of this test is shown by the fact that it would appear logically to support injunctive relief, while this Court has emphasized that compensation, rather than an injunction, is generally the proper remedy for a taking.

B. This Court's statement in *Agins* that a government regulation of property may effect a taking if it does not "substantially advance legitimate state interests" actually reflects the traditional test for a substantive violation of the Due Process Clause, rather than a test for a violation of the Just Compensation Clause. The touchstone of substantive due process is protection against arbitrary government action, the same inquiry at issue in

the "substantially advance" test. The *Agins* Court in fact relied solely upon due process precedents for the "substantially advance" formulation, and its statement was dictum, since the legitimacy of the government's purposes was not disputed in that case. In historic context, the Court's intermingling of due process and takings principles is understandable, but the Court's due process precedents rest on a doctrinal basis that is distinct from, and inapposite to, takings law.

C. There is no sound reason why this Court should not now clarify that the "substantially advance" formulation represents a due process inquiry, rather than a test for a taking under the just Compensation Clause. This Court has never squarely relied upon this supposed standard, apart from two cases addressing exactions. The exaction cases rest on their own doctrinal foundation, and the demanding standards established in those cases will not be affected by declaring that the "substantially advance" test is a due process, rather than a takings, inquiry.

II. Even if means-ends analysis were appropriate under the Just Compensation Clause, the judgment of the Ninth Circuit should be reversed because that court used an inappropriately exacting standard of review. The District Court conducted a trial to determine, as a question of "predictive fact," and without the normal deference shown to legislative policymaking, whether Act 257 would actually achieve its purposes, and the Ninth Circuit expressly upheld this *de novo* review of the wisdom of the legislature's judgment. This dramatic departure from the deferential review normally accorded economic legislation has no foundation in logic or the precedents of this Court.

A. The lower courts' *de novo* review of the substantive wisdom of Act 257 represents an extraordinary deviation from the deferential standard of review appropriate in constitutional challenges to economic legislation. Since the demise of the *Lochner* era, this Court has emphasized that it will not second-guess the efficacy of state laws regulating

economic matters. The Court's commitment to judicial restraint in its review of economic legislation is based on important principles of democratic self-governance, institutional competence, and federalism. Nothing in the Just Compensation Clause justifies a departure from these settled principles of deferential review.

B. Assuming that the "substantially advance" test were a valid taking test, this Court's decisions support application of deferential review to claims under this test. The *Agins* Court itself gave broad deference to the public purposes served by the zoning law before it, and its contemporaneous statements indicate that the Court viewed the "substantially advance" test as a continuation of normal principles of deferential review. The Court has subsequently agreed unanimously that courts should not inquire into the efficacy of laws under the Just Compensation Clause. Nothing in this Court's subsequent decisions justifies the Ninth Circuit's disregard of this teaching.

ARGUMENT

INTRODUCTION

The Court of Appeals ruled in this case that the rent cap imposed by Act 257 effected an unconstitutional "taking" of Chevron's property under the Just Compensation Clause, even though (a) Chevron has never suggested that Act 257 directly appropriated any of its property interests, (b) the Court of Appeals itself concluded that Chevron had not been denied the economically beneficial use of its property, and (c) Chevron acknowledged that the income it will receive from its property under Act 257 satisfies any constitutional standard. The Court of Appeals understood language in this Court's decision in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), to support a finding of a taking if a court concludes that state legislation would not successfully accomplish its intended goal. Moreover, in applying this anomalous test, the Ninth

Circuit believed it was appropriate for the trial court to conduct a trial to determine, as a matter of "predictive fact," and without any deference to the legislature's policy judgment, whether the challenged law would actually accomplish its purpose. As the State explains below, this extraordinary decision is irreconcilable with the precedents of this Court and the basic principles governing takings jurisprudence.

I. THE ALLEGED FAILURE OF ECONOMIC LEGISLATION TO "SUBSTANTIALLY ADVANCE A LEGITIMATE STATE INTEREST" DOES NOT SUPPORT A CLAIM OF A TAKING UNDER THE JUST COMPENSATION CLAUSE

A. The "Substantially Advance" Test Is At Odds With Basic Principles of Takings Jurisprudence

1. The Fifth Amendment provides: "[N]or shall private property be taken for public use, without just compensation." U.S. Const. Amend. V. As this Court has observed, the plain language of the Amendment – which refers to the government's "tak[ing]" of private property – does not appear to address regulations of the use of property, but rather applies most naturally to government appropriations and invasions of private property. Indeed, "early constitutional theorists did not believe the Takings Clause embraced regulations of property at all." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1028 n.15 (1992). Thus, until this Court's decision in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922), "it was generally thought that the Takings Clause reached only a 'direct appropriation' of property, or the functional equivalent of a 'practical ouster of [the owner's] possession.'" *Lucas*, 505 U.S. at 1014 (citation omitted).

The Court has long abandoned a purely literal reading of the language of the Amendment, of course, and has

concluded that a government regulation of property may constitute a taking of property that requires payment of "just compensation" to the owner. Nonetheless, the language and original understanding remain powerful touchstones in applying the Just Compensation Clause, for the Court has confined its doctrine of regulatory takings to severe use restrictions that are analogous to direct appropriations. Thus, as the Court explained in *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 199 (1985), in determining whether regulatory measures go "too far," a court's task is "to distinguish the point at which regulation becomes so onerous that it has the same effect as an appropriation of the property through eminent domain or physical possession." *See also Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 322 n.17 (2002) (regulatory taking occurs when "a law or regulation imposes restrictions so severe that they are tantamount to a condemnation or appropriation").

To implement this basic understanding of regulatory takings doctrine, the Court has developed a comprehensive framework for analysis – no aspect of which is at issue or questioned in this case – that focuses largely, if not exclusively, on a regulation's economic impact on the particular claimant.[5] In *Lucas*, the Court recognized that a regulation that denies an owner all economically viable use of property will almost invariably be deemed a taking. 505 U.S. at 1015. Outside the *Lucas* category, the Court applies a more nuanced analysis based on its decision in

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[5] For cases involving regulations that result in actual physical occupations, the Court has employed a distinct analysis that is irrelevant to a case such as this one, which clearly does not involve physical occupation of property. *See Tahoe-Sierra*, 535 U.S. at 392 (observing that "it [is] inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim that there has been a 'regulatory taking,' and vice versa").

Penn Central Transp. Co. v. New York City, 438 U.S. 104 (1978), which has been recognized as "the polestar" of the Court's regulatory takings doctrine. *See Palazzolo v. Rhode Island*, 533 U.S. 606, 633 (2001) (O'Connor, J., concurring); *see also Hodel v. Irving*, 481 U.S. 704, 713 (1987) (referring to *Penn Central* framework as "firmly established"). The *Penn Central* framework also makes the economic impact of a regulation central to the analysis, including an examination of "[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations." 438 U.S. at 124.[6]

Thus, while the Just Compensation Clause is intended in a general sense to deter oppressive and unfair governmental action, it accomplishes this purpose through the specific means of requiring the government to pay for appropriations of property and use restrictions of analogous severity. As the Court observed in *Armstrong v. United States*, 364 U.S. 40, 49 (1960), "[t]he Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *See also San Diego Gas & Elec. Co. v. City of San Diego*, 450 U.S. 621, 656 (1981) (Brennan, J., dissenting). Conversely, a government regulation that does not impose severe burdens on a

[6] The Ninth Circuit, in its initial opinion in this case, summarily rejected the theory that Chevron had suffered a taking under *Lucas*. Pet. App. 77. Chevron has never asserted a claim under *Penn Central*, and it is unlikely that it could raise such a claim at this late date, after a full trial at which it had the opportunity to present all its takings theories. In any event, such a claim should fail, given the heavily regulated nature of the wholesaler-dealer relationship and the lack of any showing of constitutionally significant economic injury as a result of the enactment of Act 257.

property owner or severely diminish the value of property does not implicate the concerns animating the Just Compensation Clause. *See Penn Central*, 438 U.S. at 135-38; *Kirby Forest Indus. v. United States*, 467 U.S. 1, 15-16 (1984); *Andrus v. Allard*, 444 U.S. 51, 65-67 (1979).

Given the focus in *Penn Central* and the Court's other regulatory takings cases on the severity of a regulation's economic impact on a property owner, it is evident that the means/ends scrutiny applied by the Court of Appeals is out of place in regulatory takings doctrine. The "substantially advance" test, as applied by the Court of Appeals, addresses the *effectiveness* of government action, not its economic impact, and in fact utterly disregards adverse economic impact. Thus, under the "substantially advance" formulation, a law can be declared an unconstitutional taking if a court concludes that it will not accomplish its intended aim, even if its economic impact is minimal.

This case represents a stark illustration of the anomalous nature of this ostensible takings test. The Ninth Circuit held Act 257 to be a taking even though Chevron stipulated that it will receive under the provisions of Act 257 "a return that satisfies any Constitutional standards on its investment" in its service stations in Hawaii, and admitted that it can receive more rent in aggregate under the law than it would otherwise charge. JA 40, 47. While Chevron's objection to the Act arguably raised a colorable issue under the Due Process Clause, it did not raise a concern that Chevron's property was being taken without just compensation.

2. The "substantially advance" test is also inconsistent with the Court's settled understanding, based on the language of the Just Compensation Clause, that the principal purpose of the Clause is not to interpose substantive barriers to government appropriation of private property, but rather to ensure that "just compensation" is paid when the government takes such action. As the Court

explained in its landmark decision in *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 314 (1987):

> [The Just Compensation Clause] does not prohibit the taking of private property, but instead places a condition on the exercise of that power. . . . This basic understanding of the Amendment makes clear that it is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking.

Thus, when a government action effects a taking, the Just Compensation Clause requires compensation – nothing more – and a violation of the Clause is established when the government fails to pay compensation for a taking of private property. *See Brown v. Legal Foundation of Washington*, 538 U.S. 216, 235 (2003), *quoting Williamson County*, 473 U.S. at 194 ("The Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation.").[7] *See also City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 714 (1999), ("If the condemnation proceedings do not, in fact, deny the landowner just compensation, the government's actions are neither unconstitutional nor unlawful."). If a court concludes that the government has engaged in a "taking" of private property – either through outright appropriation or severe regulation – then the government

[7] This point explains why taking claims must ordinarily first be pursued through any compensation procedures that the State has established; unless and until the State definitively refuses compensation, no unconstitutional taking of property *without* just compensation has occurred. *See Williamson County*, 473 U.S. at 194-95. The Ninth Circuit, however, has allowed claimants pursuing a "substantially advance" taking claim to skip state compensation remedies and proceed directly to federal court. *See* p. 22 n.10, *infra*.

must pay just compensation; the government is, in effect, required to act as if it had purchased the property at fair market value (rather than, for example, being required to pay consequential damages). *See United States v. 564.54 Acres of Land*, 441 U.S. 506, 511 (1979). But it is equally true that, if the government *does* properly compensate the property owner, the constitutional imperative of just compensation is satisfied. "Taking" analysis then has no further role to play, for as the Clause makes clear, what a "taking" of private property requires in return is just compensation. The "substantially advance" test, however, ignores the compensatory purpose of the Just Compensation Clause, focusing instead on whether the government action can proceed at all.

3. Furthermore, the substantially advance test is inconsistent with the basic understanding, also rooted in the language of the Fifth Amendment, that exercise of the taking power is conditioned on the government's serving a legitimate "public use." As the Court recognized in *First English*, the Just Compensation Clause requires compensation for burdensome – but "otherwise proper" – government impairments of property interests. 482 U.S. at 314. If the "otherwise proper" governmental action amounts to a "taking," then compensation must ensue; but if the governmental action is *not* "otherwise proper" then the government may not take the property at all, and whether or not the governmental action would be severe enough to amount to a "taking" is wholly irrelevant. Given that the Just Compensation Clause presupposes that the government is pursuing a legitimate public purpose, the Clause cannot, as a logical or legal matter, support a claim of a taking based on allegedly *illegitimate* governmental action.

The understanding that a valid government action is a prerequisite for invoking the taking power has been a part of takings doctrine from its inception to the present day. As the Court explained in *Hawaii Housing Authority v.*

Midkiff, 467 U.S. 229, 245 (1984), governmental action that could not "withstand the scrutiny of the public use requirement ... would serve no legitimate purpose of government and would thus be void." *See also Mahon*, 260 U.S. at 415 ("The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides that it shall not be taken for such use without compensation."); *Brown v. Legal Foundation of Washington*, 538 U.S. 216, 231 (2003) (stating that a "condition" for any exercise of the government's taking power is that the government action serve a "public use," and equating this requirement with a requirement that the government action be "legitimate").

If a government proposal to take private property does not serve a public use, then the action cannot be a valid taking for which compensation would be required under the Just Compensation Clause. The government may not use its power of eminent domain to take property for an improper purpose, regardless of whether compensation is offered or available through the courts. *See Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55, 80 (1937) ("[O]ne person's property may not be taken for the benefit of another private person without a justifying public purpose, even though compensation be paid."). That is true, moreover, whether the issue arises in a condemnation case or an inverse condemnation case. *See San Diego Gas & Elec.*, 450 U.S. at 656 n.23 (Brennan, J., dissenting) (noting that a "government entity may not be forced to pay just compensation" for a regulation that was invalid because it lacked a "public use"); *Brown*, 538 U.S. at 231. If a government regulation is arbitrary or irrational, it cannot become permissible as a result of a government offer to pay compensation, and it would make no sense to impose an obligation on the public to pay just compensation for a regulation that is invalid and must therefore be rescinded.

This presupposition of a legitimate "public use" demonstrates that the validity of the government action *is* a relevant consideration in takings cases. The issue arises, however, not in assessing whether the government action amounts to a "taking," but in the entirely distinct inquiry into whether the government's action serves a "public use."[8] Thus, for example, when the fact of a taking is undisputed, as when the government directly deploys its eminent domain power, it may be necessary to inquire whether the action serves a legitimate public purpose. *See National R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407 (1992); *Berman v. Parker*, 348 U.S. 26, 32 (1954). But where the question at issue is whether there has been a "taking," the answer cannot turn on whether or not the government action serves a valid public purpose. Indeed, if there is no predicate taking, caused by a direct appropriation or a severely burdensome regulation, there is no need for a court to even address the public use issue, because the public use requirement becomes pertinent only if a taking has in fact been demonstrated.

4. Finally, the "substantially advance" theory of takings conflicts with the Court's longstanding rule that compensation, not an injunction, is ordinarily the appropriate remedy for a taking under the Just Compensation Clause. In accord with the "basic understanding" that the purpose of the Just Compensation Clause is to provide

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[8] *See Palazzolo*, 533 U.S. at 635 n.* (O'Connor, J., concurring) (distinguishing the question "whether the enactment or application of a regulation constitutes a valid exercise of the police power" from the "second question ... whether the state must compensate a property owner for a diminution in value effected by the State's exercise of its police power"); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 511 (1987) (Rehnquist, C.J., dissenting) (that a regulation serves a public purpose "does not resolve the question whether a taking has occurred; the existence of such a public purpose is merely a necessary prerequisite to the government's exercise of its taking power").

compensation, "not to limit the governmental interference with property rights per se," *see First English*, *supra*, the Court has repeatedly stated that a plaintiff may not obtain an injunction under the Just Compensation Clause to block an alleged taking. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1016 (1984) ("Equitable relief is not available to enjoin an alleged taking of private property for a public use, duly authorized by law, when a suit for compensation can be brought against the sovereign subsequent to the taking."); *accord Preseault v. ICC*, 494 U.S. 1, 11 (1990).[9]

Nonetheless, the Ninth Circuit has ruled that claimants are entitled routinely to seek injunctive relief in a taking suit based on the "substantially advance" theory. *See, e.g., Daniel v. County of Santa Barbara*, 288 F.3d 375, 384-85 (9th Cir. 2002).[10] On one level, this conclusion is

[9] The Court has recognized a narrow exception to this general rule where, as a practical matter, it would impossible for the government to remedy the alleged taking through payment of compensation. *See Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59, 71 n.15 (1978) (equitable relief available under the Just Compensation Clause to prevent "potentially uncompensable damages" that might be sustained after a nuclear event). *See also Babbitt v. Youpee*, 519 U.S. 234 (1997) (enjoining statute severely impairing right to devise property). In addition, in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), a plurality of the Court suggested that, to the extent a taking claim may be based on a government mandate that one private party pay out funds to another private party, a suit may be brought under the Just Compensation Clause to prevent an enforcement of such an obligation. Neither exception applies in this case.

[10] Consistent with the view that injunctive relief is an appropriate remedy under this takings theory, the Ninth Circuit has also ruled that a claimant raising a "substantially advance" taking claim may file suit immediately in federal court and has no obligation to exhaust available state compensation procedures, as ordinarily required under *Williamson County*, 473 U.S. at 185-97. *See, e.g., Daniel*, 288 F.3d at 385. The ability of takings claimants invoking this theory to avoid state exhaustion requirements, combined with the heightened level of scrutiny under Ninth Circuit precedents, means that litigants challenging state

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perfectly logical, for if a regulation is substantively void, then it should be enjoined; payment of compensation cannot authorize an invalid government action to continue, and the public should not be required to pay just compensation for an invalid action. But that very point demonstrates that inquiry into the substantive validity of a regulation is alien to regulatory takings doctrine. An injunction would be an appropriate remedy if the purpose of the Just Compensation Clause were to block government from engaging in illegitimate conduct. But an injunction is not an appropriate remedy precisely because, as explained above, the purpose of the Just Compensation Clause is not to block illegitimate action, but rather to provide compensation for burdensome, but "otherwise proper," government action.

B. The "Substantially Advance" Test Is Actually The Test For A Substantive Due Process Violation.

There is no question that, in *Agins* and some later cases, the Court has *stated* that a government regulation of property may amount to a taking if it does not "substantially advance legitimate state interests." As we now explain, however, this locution resulted from a mistaken transposition of substantive due process doctrine into takings law, where it does not belong. With the exception of two cases arising in the distinct context of exactions imposed as conditions for development permits, which readily stand on a separate doctrinal footing, the Court has never actually *held* a government regulation to be a "taking" under this language. Accordingly, the Court

and local regulations will routinely file in federal rather than state court. Thus, the issue raised by this case has significant implications for forum shopping between the federal and state courts, as well as for the potential burdens such claims may impose on federal courts.

should recognize the "substantially advance" language for what it is: the traditional test for a substantive violation of the Due Process Clause.

1. The "substantially advance" language merely restates the traditional inquiry into the substantive validity of regulation under the Due Process Clause. The Court has "emphasized time and again that '[t]he touchstone of due process is protection of the individual against arbitrary action of government,'" including "the exercise of power without any reasonable justification in the service of a legitimate governmental objective." *County of Sacramento v. Lewis*, 523 U.S. 833, 845 (1998) (quoting *Wolff v. McDonnell*, 418 U.S. 539, 558 (1974)); *see also State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 417 (2003) (grossly excessive punitive damages award "furthers no legitimate purpose and constitutes an arbitrary deprivation of property" in violation of due process). The "substantially advance" takings test asks exactly the same questions as the due process test: are the government's ends legitimate, and has it selected appropriate means to accomplish those ends? This takings test is simply due process analysis under a different label.

This point is confirmed by the fact that the Court's takings decisions first articulating the test relied exclusively on due process precedents. The Court in *Agins* cited *Nectow v. Cambridge*, 277 U.S. 183, 188 (1928), which held that a restriction on the use of property "cannot be imposed if it does not bear a substantial relation to the public health, safety, morals, or general welfare." The decision in *Agins* also cited *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926), which upheld a municipal ordinance under a similar standard. 447 U.S. at 260-61. But neither *Nectow* nor *Euclid* involved claims under the Just Compensation Clause. Rather, the plaintiffs in each case contended that the regulations deprived them of property "without due process of law." *Nectow*, 277 U.S. at 185; *Euclid*, 272 U.S. at 384. In both cases, the constitutionality of the challenged

regulation was perceived by the Court as turning on whether it constituted a legitimate exercise of its police power, or was instead fundamentally arbitrary – a quintessential question of substantive due process. *See Nectow*, 277 U.S. at 187-88; *Euclid*, 272 U.S. at 387.

The Court's recitation in *Agins* of the "substantially advance" language as a test for a taking was dictum. Not only did the Court uphold the ordinance, but neither party raised any factual question about whether the ordinance was reasonably related to legitimate public purposes. Nor did either party suggest that a regulation's failure to advance a legitimate public purpose could render it a taking. To the contrary, both sides quite clearly presumed that governmental action may not be deemed a "taking" *unless* the regulation represents a valid exercise of governmental power.[11] The opinion in *Agins* also offered no explanation for why principles of substantive due process should be incorporated into takings doctrine.[12]

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[11] The claimant property owners in *Agins* challenged the California court's description of a regulatory taking as a "wrongful" act, *see Agins* (No. 79-602) Appellants' Brief at 16-17, and insisted that a regulatory taking claim focuses instead on "whether the proper exercise of this proper power nonetheless worked a taking by reason of its impact on the regulated property." *Id.* at 18-19. Moreover, the plaintiffs explicitly accepted the validity of the city's zoning ordinance. *See id.* at 17 n.5. Likewise, the defendant city distinguished the issue of whether the ordinance served a legitimate government interest, which it considered a question of *substantive due process*, *Agins* (No. 79-602) Appellees' Brief at 16-18, from the separate question of whether the adverse economic impact of the ordinance resulted in a *taking*. *Id.* at 18-22.

[12] For a sampling of scholarly commentary making the same observation that the "substantially advance" language in *Agins* was unsupported by precedent except substantive due process cases, *see* Kenneth Bley, *Substantive Due Process and Land Use: the Alternative to a Takings Claim*, in *Takings: Land-Development Conditions And Regulatory Takings After* Dolan *And* Lucas 289, 291 (1996); Frank Michelman, *The Jurisprudence of Takings*, 88 COLUM. L. REV. 1600, 1605-14 (1987); Jerold Kayden, *Land-Use Regulations, Rationality, and*

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The Court's reference in *Agins* to its due process cases was foreshadowed by language in the Court's opinion in *Penn Central*. In that case, the Court, citing due process precedents, noted that it had upheld land-use regulations restricting property interests where such regulations promoted the public health or welfare. *See* 438 U.S. at 124-25. The Court described *Goldblatt v. Hempstead*, 369 U.S. 590 (1962), as an example of a case in which this analysis had been applied, and then observed: "It is, of course, implicit in *Goldblatt* that a use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose. . . . " 438 U.S. at 127 (citing *Nectow*). This statement by the Court in *Penn Central* was clearly dictum, for there was no dispute in that case regarding whether New York City's efforts to preserve historic Grand Central Terminal advanced a legitimate public purpose. *See id.* at 129.

In any event, *Goldblatt* was, like *Nectow* and *Euclid*, a due process case. The plaintiffs' claim in *Goldblatt* was that a municipal ordinance violated the Due Process Clause, 369 U.S. at 591, and the Court viewed the issue, as in its previous due process cases, as whether the regulation "is a valid exercise of the town's police power." *Id.* at 594. The Court in *Goldblatt* separately addressed the possibility that the ordinance might constitute "a taking which constitutionally requires compensation," but then ruled that the potential taking claim could not prevail because there was no evidence demonstrating that the regulation had reduced the value of the property. *Id.* In

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Judicial Review: The RSVP in the Nollan *Invitation*, 23 URB. LAW. 301 (1991); Kenneth Salzberg, *"Takings" as Due Process, or Due Process as "Takings"?*, 36 VAL. U. L. REV. 413 (2002); Ronald J. Krotoszynski, Jr., *Expropriatory Intent: Defining The Proper Boundaries of Substantive Due Process and the Takings Clause*, 80 N.C. L. REV. 713 (2002); D. Benjamin Barros, *The Police Power and the Takings Clause*, 58 U. MIAMI L. REV. 471 (2004).

short, while *Goldblatt* did address both due process and takings theories, nothing in that opinion suggests that an alleged due process violation also can support a claim of a taking under the Just Compensation Clause, and the Court's taking analysis in *Goldblatt* focused on precisely the right factor – the economic impact of the regulation, not its workability or the fit between its means and ends.

2. Viewing *Agins* in historical context, it is not difficult to understand the Court's intermingling of due process and takings doctrine. *Agins* was one of the Court's first major cases in almost fifty years dealing with constitutional challenges to municipal land use regulation, and so the Court naturally referred back to its earlier decisions, *Nectow* and *Euclid*, that had addressed the constitutionality of zoning and urban planning. However, as explained above, those earlier cases rested on a doctrinal basis that was distinct from the concept of a taking in violation of the Just Compensation Clause.

The Court's intermingling of takings and due process doctrines in *Agins* may further be explained by the fact that the exact nature of the relation between the two doctrines was far more uncertain at the time that case was decided than it is today. For example, there was significant uncertainty at that time about whether a regulation that went "too far" in its effect on property constituted a "taking" for which just compensation might be due, or whether instead such a regulation constituted an invalid police power regulation in violation of the Due Process Clause. *See, e.g., Fred F. French Investing Co. v. City of New York*, 350 N.E.2d 381, 384-86 (N.Y. 1976) (adopting the latter view). The Justices of this Court debated this issue for several years. *See, e.g., Williamson County*, 473 U.S. at 197-200. The issue was not definitively resolved until the Court's decision in *First English*, which squarely held that the Just Compensation Clause requires a compensation remedy for regulations that are so onerous that they amount to takings. 482 U.S. at 314-17. The now-superseded theory

that a regulation that amounts to a taking can *only* be challenged under the Due Process Clause does not logically support the inverse proposition – that a substantively illegitimate government action that violates due process constitutes a taking in violation of the Just Compensation Clause. But the uncertainty generated by this theory about the proper relationship between takings and due process helps explain the Court's invocation of due process concerns as if they were also central to takings cases.

Finally, the confusion about the relationship between takings and due process doctrines in *Agins* may have reflected the Court's use in some earlier cases of terminology that blurred the distinction between the two doctrines. Thus, the Court variously described government actions challenged under the Constitution as an alleged "taking without due process of law," *Rowan v. U.S. Post Office Dep't*, 397 U.S. 728, 740 (1970), or an alleged "taking . . . of property without due process of law, and a taking of . . . property without just compensation." *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 244 (1964). This confusing terminology may well have reflected the underlying confusion during this period about the relationship between these two doctrines. In any event, it too helps explain the problematic language in *Agins* that has given rise to the "substantially advance" takings test.

Whatever the explanation, it is clear that the "substantially advance" formulation is a due process inquiry, not a takings test. The State is aware of no principled explanation for why due process analysis could or should be incorporated into takings doctrine for the purpose of deciding whether a taking has occurred.

C. Nothing Bars This Court From Clarifying That The "Substantially Advance" Test Represents A Due Process Inquiry, Rather Than A Takings Test

The State anticipates that Chevron will make at least three arguments against the clarification of takings doctrine outlined above. Chevron will likely argue that (1) the substantially advance test is "deeply embedded" in the Court's takings jurisprudence, and therefore it is too late in the day to bring order to regulatory takings doctrine, *see* Br. in Opp. 17; (2) judicial recognition that the "substantially advance" test is not a valid takings test would require the Court to overrule *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), and *Dolan v. City of Tigard*, 512 U.S. 374 (1994); and (3) the "substantially advance" test should be preserved because it provides a necessary protection for private property interests. There is no merit to these arguments.

1. A review of the Court's takings precedents shows that the "substantially advance" test, far from being "deeply embedded" in takings doctrine, actually hangs by a gossamer thread, if indeed it is actually part of current takings doctrine at all. As discussed, the recitation of this test in *Agins* itself was dictum. Moreover, repudiation of this ostensible test would not cast doubt on the result of even one of this Court's takings decisions. In the 25 years since *Agins*, the Court has never (outside the special context of exactions, discussed below) squarely sustained a claim of a regulatory taking under the "substantially advance" theory. The majority of the Court's regulatory takings decisions during this period rely on the well-established *Penn Central* framework. They either ignore *Agins* altogether, *see, e.g., Ruckelshaus*, 467 U.S. at 1004-05, or rely on *Agins* solely for the second (and unquestioned) proposition articulated in that case – namely, that a regulation will be deemed a taking if it denies the owner

all economically viable use of the property. *E.g., Palazzolo*, 533 U.S. at 617.

Not only has the Court never (apart from the unique setting of exactions) relied on the "substantially advance" language in *Agins* to find a taking, but it has several times expressly questioned the validity of that theory. In the Court's most significant recent case to address whether the alleged illegitimacy of government action can support a taking claim, *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), the majority of the Justices concluded that such an allegation falls outside the scope of the Just Compensation Clause. *Eastern Enterprises* involved a constitutional challenge to the Coal Industry Retiree Health Benefit Act, which imposed retroactive liability on former coal mine operators to fund the increased heath care costs of retired mine workers. The Court struck down the statute as unconstitutional, but could not agree on a rationale, with four Justices concluding that the statute effected a taking and a fifth, Justice Kennedy, concluding that the statute violated only the Due Process Clause.

Five Justices – Justice Kennedy and the four dissenters – viewed the case as turning on the legitimacy *vel non* of the law, and concluded that that issue necessarily arose only under the Due Process Clause, and not the Just Compensation Clause. Justice Kennedy concluded that the legislation was "arbitrary" and "must be invalidated as contrary to essential due process principles." *Id.* at 539 (Kennedy, J., concurring in judgment). But precisely because the case involved an allegation of arbitrary action, he also concluded that the Just Compensation Clause did not apply. Justice Kennedy acknowledged that the Court had stated that a taking can occur if the government action does not "substantially advance legitimate state interests," but observed that "[t]his sort of analysis is in uneasy tension with our basic understanding of the Takings Clause, which has not been understood to be a

substantive or absolute limit on the government's power to act." *Id.* at 545. He therefore concluded that the Court should "reserv[e] takings analysis for cases where the governmental action is otherwise permissible." *Id.* at 546. Because the constitutionality of the Coal Act turned on "the legitimacy of Congress' judgment rather than on the availability of compensation, the more appropriate constitutional analysis arises under general due process principles rather than under the Takings Clause." *Id.* at 545.

Justice Breyer, joined by three other Justices, agreed that review of the arbitrariness of government action is governed by the Due Process Clause and not the Just Compensation Clause. Like Justice Kennedy, Justice Breyer concluded that the "Takings Clause does not apply." *Id.* at 554. He observed that "at the heart of the Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for legitimate government action that takes 'private property' to serve the 'public' good." *Id.* There is "no need to torture the Takings Clause," he wrote, to accommodate claims of arbitrariness that have a "natural home in the Due Process Clause, a Fifth Amendment neighbor." *Id.* at 556.

It is fairly debatable whether the agreement of the concurring and dissenting Justices in *Eastern Enterprises*, together making up a majority of the Court, should be treated as a binding precedent on whether an allegation of arbitrary government action can support a claim of a taking under the Just Compensation Clause. *Cf. Marks v. United States*, 430 U.S. 188 (1977). What is not debatable is that the various opinions in *Eastern Enterprises* refute the argument that the "substantially advance" test is deeply embedded in the Court's takings jurisprudence, given that five Justices expressly rejected the validity of that test.

Shortly after *Eastern Enterprises* was decided, the Court again confronted the issue and demonstrated that it

viewed the validity of the "substantially advance" test as unsettled. In *City of Monterey v. Del Monte Dunes at Monterey, supra,* the Court could not reach the issue because the defendant city had waived any objection to the application of the "substantially advance" test. The Court declined the urging of the United States, as amicus, that it declare definitively that the "substantially advance" test is not a takings test, observing that this test was "consistent with our previous general discussions of regulatory takings liability," *id.* at 704 – a point that was indisputably true, given the Court's dictum in *Agins*. Even so, the Court acknowledged in *Del Monte Dunes* that it has never provided "a thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions." *Id.* To like effect, Justice Souter in dissent, joined by three other Justices, expressly "offer[ed] no opinion here on whether *Agins* was correct in assuming that this prong of liability was properly cognizable as flowing from the Just Compensation Clause of the Fifth Amendment, as distinct from the Due Process Clauses of the Fifth and Fourteenth Amendments." *Id.* at 753 n.12 (Souter, J., dissenting). And Justice Scalia, in his separate opinion, similarly "express[ed] no view as to [the] propriety" of the *Agins* language as a takings test. *Id.* at 732 n.2 (Scalia, J., concurring). Thus, every Justice wrote or joined in an opinion casting doubt on the applicability of the "substantially advance" takings test.

Aside from these cases, the Court has confronted a claim that a regulation failed to advance a legitimate governmental interest in only two cases, *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987), and *Yee v. City of Escondido*, 503 U.S. 519 (1992). Neither decision supports the validity of this takings theory. In *Keystone*, the state government did not challenge the "substantially advance" theory, and the Court's rejection of the claim on the merits does not stand as a holding that

the "substantially advance" test is in fact valid. In *Yee*, the Court declined to resolve whether a challenged rent control ordinance constituted a taking under the "substantially advance" theory, since that issue was not within the scope of the question on which the Court had granted certiorari. *See* 503 U.S. at 533-38. In sum, a clear statement by the Court that the "substantially advance" test is not a test for a taking would not affect the result in any prior decision of this Court. To the contrary, it would simply confirm the already widely held view that this is not a taking test but rather represents a due process inquiry.[13]

2. The conclusion that the "substantially advance" language is not a valid takings test does not affect this Court's decisions in *Nollan* and *Dolan*. These decisions establish special legal standards to address the situation where government officials, in the context of individual land use permitting decisions, seek to attach permit conditions requiring owners to grant the public continuous access to their property. These decisions are explained by, and are logically confined to, the context of exactions.

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[13] Not surprisingly, given the Court's own express ambivalence about this ostensible takings test, the lower federal and state courts have been reluctant to rely on this takings theory and have rarely done so. *See, e.g., State v. City of Mayfield Heights*, 765 N.E.2d 345, 351 (Ohio 2002); *Whitehead Oil Co. v. City of Lincoln*, 515 N.W.2d 401, 408-12 (Neb. 1994). Many lower courts have simply referred to the test in passing or ignored it altogether. In the Court of Federal Claims, which hears virtually all takings claims against the United States, there is apparently not a single decision upholding a taking claim under this theory. *See Seiber v. United States*, 364 F.3d 1356, 1367-68 (Fed. Cir. 2004) (noting that the Supreme Court has "declined to decide the continued viability of *Agins*," but finding it unnecessary to resolve the validity of the theory because the challenged federal program served a legitimate public purpose); *Bamber v. United States*, 45 Fed. Cl. 162, 165 (1999) ("This alternative takings analysis, first alluded to in *Agins*, has not had a fruitful life.").

Nollan and *Dolan* are best understood as a species of physical appropriation cases. If the conditions at issue in those cases had been imposed independently of a development permit, they would unquestionably have constituted *per se* takings under *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 (1982). The question the Court faced in these cases was whether and under what circumstances the government could avoid takings liability if such requirements were attached to permits that the government could have denied, without incurring takings liability, in the proper exercise of its regulatory authority. The Court resolved this problem by ruling that such conditions will not effect a taking when (1) there is a "nexus" between the conditions and the government's regulatory purposes, *Nollan*, 483 U.S. at 837, and (2) there is a "rough proportionality" between what the owner surrendered and the impact of the proposed development, *Dolan*, 512 U.S. at 391.

As the Court explained in *Dolan*, these requirements of a nexus and rough proportionality essentially serve as a version of the unconstitutional-conditions doctrine in this unusual context. 512 U.S. at 385. If the exaction is closely related to the government's programmatic interest, that tends to show that government officials are not using a regulatory review process as a pretext for appropriating property. *Cf. FCC v. League of Women Voters*, 468 U.S. 364, 388 (1984) (finding violation of First Amendment under unconstitutional conditions doctrine where challenged restriction did not "substantially advance" asserted governmental interest). By contrast, if there is little relation because the government's objective and the exaction, that suggests that the government might be engaging in a kind of regulatory "extortion" by imposing unconstitutional conditions in ad hoc permitting decisions. *See Nollan*, 483 U.S. at 837.

Nollan and *Dolan* can and should easily survive repudiation of the "substantially advance" language as a

general test for a regulatory taking. Those cases are not traditional regulatory takings cases at all; rather, they stand at a unique intersection of physical-occupations law and the unconstitutional conditions doctrine. They rest on their own foundations as a means to address the potential for abuse in government exactions in the permitting context and have little significance outside that unusual domain. Indeed, in *Dolan* the Court indicated that the type of exacting scrutiny applied to ad hoc exactions could not properly be applied to general legislation. 512 U.S. at 385. The Court subsequently ruled that the "rough proportionality" test of *Dolan* (and, by clear implication, the *Nollan* "essential nexus" test as well) does not extend "beyond the special context of exactions – land-use decisions conditioning approval of development on the dedication of property to public use." *Del Monte Dunes*, 526 U.S. at 702. These limitations further indicate that the Court understood its use of the "substantially advance" language in *Nollan* and *Dolan* as a response to the special concerns raised by those cases, and not as one instance of a more general substantive limitation on regulatory authority affecting private property.

3. Finally, there is no merit to the potential argument that endorsing the problematic "substantially advance" theory is somehow necessary to preserve important protections for private property. The State's position is not that constitutional means-ends analysis should be eliminated or discarded, but rather that it should be recognized for what it is: an inquiry that belongs under the Due Process Clause. Whatever protection property owners have under the "substantially advance" test can properly be provided directly under the Due Process Clause, without the confusing intermediation of the Just

Compensation Clause, and with the proper level of deferential review appropriate to state economic regulation.[14]

The State recognizes that substantive due process is a somewhat disfavored category of constitutional analysis. But due process review, though deferential, is not toothless. *See State Farm*, 538 U.S. at 417 (invalidating punitive damages award under substantive due process); *BMW of North Am. v. Gore*, 517 U.S. 559, 569 (1996) (same). *Cf. Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster County*, 488 U.S. 336, 343 (1989) (invalidating county's tax assessments under Equal Protection Clause). To be sure, substantive due process analysis raises profound questions about the authority of courts to engage in the kind of normative analysis ordinarily left to the political branches. But relabeling what in reality is a due process inquiry as a takings test does not "avoid making a normative judgment," for the Courts "must make the normative judgment in all events." *Eastern Enters.*, 524 U.S. at 544 (Kennedy, J., concurring in judgment). Accordingly, the Court should now make clear that, outside the exactions context, the question whether a regulation substantially advances a legitimate state interest has no place in takings law.

[14] The Ninth Circuit has gone beyond embracing the ostensible "substantially advance" takings test to rule that property owners challenging regulations as arbitrary or illegitimate in a constitutional sense *must* bring their claims under the Just Compensation Clause rather than the Due Process Clause. *See, e.g., Macri v. King County*, 126 F.23d 1125, 1129 (9th Cir. 1997). In other words, the Ninth Circuit has arrived at the bizarre conclusion that what in reality is a due process claim *can* be brought under the Just Compensation Clause and *cannot* be brought under the Due Process Clause itself. The majority of other circuits have rejected this implausible position. *See* Robert Ashbrook, *Land Development, the Graham Doctrine, and the Extinction of Economic Substantive Due Process*, 150 U. PA. L. REV. 1255 (2002). The Ninth Circuit's problematic position will presumably evaporate if the Court affirms that substantive due process claims cannot be dressed up as takings claims.

II. IF MEANS-ENDS REVIEW WERE APPROPRIATE UNDER THE JUST COMPENSATION CLAUSE, THE NINTH CIRCUIT ERRED IN FAILING TO APPLY A DEFERENTIAL STANDARD OF REVIEW

Even if means-ends analysis were appropriate under the Just Compensation Clause, the judgment of the Ninth Circuit should be reversed because the courts below used an inappropriately exacting standard in applying this analysis. There is no question that Act 257 meets the rational-basis test traditionally applied to economic legislation, and neither Chevron nor the courts below have suggested otherwise.

A. The Standard of Review Applied By The Ninth Circuit Violates Settled Understandings About The Proper Role Of the Courts In Assessing The Constitutionality Of Economic Legislation

The heightened standard of review applied by the Ninth Circuit in this case represents an extraordinary departure from the deferential standard of review that is appropriate in constitutional challenges to economic legislation. "The day is gone when this Court uses the Due Process Clause . . . to strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought." *Williamson v. Lee Optical*, 348 U.S. 483, 488 (1955). Under the Court's modern jurisprudence, "legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality." *Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 508 U.S. 602, 637 (1993). Rent control laws have long been considered the kind of economic regulation subject to invalidation only when "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt."

Pennell v. City of San Jose, 485 U.S. 1, 11 (1988); *see also Village of Belle Terre v. Boraas*, 416 U.S. 1, 8 (1974).

In striking contrast to this established approach, the lower courts in this case openly engaged in *de novo* review of the soundness of the Hawaii legislature's economic policy judgment. The Ninth Circuit directed the District Court to determine, as a matter of "predictive fact," whether Act 257 would achieve the State's goals. Pet. App. 69-72. On remand, the District Court resolved what was in essence a public policy debate by hearing expert testimony from each side about the likely effectiveness of the law, applying a preponderance of the evidence standard and even taking into account the demeanor of each expert witness. According no deference whatsoever to the legislature's judgment, the District Court pronounced the economic analysis offered by Chevron's expert "more persuasive," and accordingly declared Act 257 unconstitutional. *Id.* at 43. On appeal, the Ninth Circuit freely acknowledged that it had imposed "heightened" scrutiny as to the "means/ends fit" in Act 257, and rejected the State's contention that the legislature's judgment on matters of economic policy deserved deference. *Id.* at 13-16.[15]

[15] The Ninth Circuit also refused to accept the State's submission as to what the purpose of Act 257 *was* – the protection of consumers through the preservation of the current, relatively unconcentrated structure of the retail market for gasoline. Rather, the Ninth Circuit asserted that the purpose of Act 257 was to reduce the retail price of gasoline from the levels at the time of enactment of the Act (an argument the State had never made). Pet. App. 18; *see* p. 9 n.4, *supra*. Similarly, the District Court discounted a central premise underlying the Act's purposes, that oil companies might attempt to apply pressure on independent dealers to effect a conversion of the stations to company control. Pet. App. 48, 52. Both courts thus departed from the settled principle that, even if the legislature has not articulated a rationale for a law, it should be upheld under rational-basis review if "any state of facts either known or which could reasonably be assumed affords support for it." *United States v. Carolene Products Co.*, 304 U.S. 144,

(Continued on following page)

The Court of Appeals' departure from fundamental principles of judicial restraint is dramatic. In the realm of economic legislation, "debatable questions as to reasonableness are not for the courts but for the Legislature," *Goldblatt*, 369 U.S. at 595, and there is "no need for mathematical precision in the fit between justification and means," *Concrete Pipe*, 508 U.S. at 639. The heightened standard of review applied by the Ninth Circuit thus contradicts the Court's modern understanding, painfully acquired over the course of the 20th Century, about the proper limits on the role of the judiciary in assessing the substantive wisdom of economic policies adopted by democratic institutions of government. In exposing the federal government, the States, and municipalities to second-guessing of their economic policy choices, the Ninth Circuit's decision threatens to revive, in the novel setting of takings law, a type of intrusive judicial review not seen in this country since the era of *Lochner v. New York*, 198 U.S. 45 (1905).

This Court's modern commitment to judicial restraint in review of economic legislation – regardless of the specific constitutional provision invoked – rests on several bedrock principles. First, tenets of democratic self-governance dictate that economic policy should be determined by elected representatives (or administrators accountable to them) rather than unelected judges. *See, e.g., Schweiker v. Wilson*, 450 U.S. 221, 230 (1981). Second, the courts lack the institutional competence to make predictive judgments concerning the efficacy of economic regulation. *See, e.g., General Motors Corp. v. Tracy*, 519 U.S. 278, 308-09 (1997). Finally, within our federal system,

154 (1938); *cf. FCC v. Beach Communications*, 508 U.S. 307, 315 (1993) ("[B]ecause we never require a legislature to articulate its reasons for enacting a statute, it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature.").

deferential review by federal courts of the actions of state legislatures prevents concentration of power in federal hands and helps preserve the states as "laborator[ies]" with freedom to conduct "novel social and economic experiments." *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

Nothing in the Just Compensation Clause justifies a departure from these settled principles of deferential review for economic legislation. Although the Clause evinces solicitude for property interests by requiring compensation when the government takes private property for public use, the mere fact that government regulation may adversely affect private property has never been understood to warrant elevated judicial scrutiny. To the contrary, the Clause "allows government *confiscation* of private property so long as it is taken for public use and just compensation is paid; mere *regulation* of land use need not be 'narrowly tailored' to effectuate a 'compelling state interest.'" *City of Cuyahoga Falls, Ohio v. Buckeye Community Hope Found.*, 538 U.S. 188, 200 (2003) (Scalia, J., concurring). *See also Keystone*, 480 U.S. at 491 ("Under our system of government, one of the State's primary ways of preserving the public weal is restricting the uses individuals can make of their property."); *Lucas*, 505 U.S. at 1027 ("the property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police powers"). And as the Court has often observed, "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." *Mahon*, 260 U.S. at 413. It would be especially anomalous to conclude that means-ends analysis under the Just Compensation Clause calls for exacting scrutiny given that this test (if it is indeed a valid taking test) was derived from due process jurisprudence, which itself plainly mandates deferential review in this type of case. *See* pp. 24-25, *supra*.

The threat to the proper balance between the federal judiciary and elected state legislatures posed by the Ninth Circuit's decision is dramatically illustrated by the contrast between this decision and the Court's decision in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), in which the Court upheld, unanimously, a statute remarkably similar to Act 257 against challenges to its economic wisdom. In that case, the Court considered due process and other challenges to a Maryland law that, like the Hawaii act that preceded Act 257, prohibited oil companies from operating their own stations within the state. The oil companies contended that the law would be counterproductive because it would reduce the number of retail outlets for gasoline in the state and thus harm consumers. The Court responded in terms that flatly contradict the approach employed by the Ninth Circuit:

> The evidence presented by the refiners may cast some doubt on the wisdom of the statute, but it is, by now, absolutely clear that the Due Process Clause does not empower the judiciary to sit as a superlegislature to weigh the wisdom of legislation. . . . Appellants argue that [prohibiting company-operated gas stations] is irrational and that it will frustrate rather than further the State's desired goal of enhancing competition. But . . . this argument rests simply on an evaluation of the economic wisdom of the statute, and cannot override the State's authority to legislate against what are found to be injurious practices in their internal commercial and business affairs. *Regardless of the ultimate economic efficacy of the statute, we have no hesitancy in concluding that it bears a reasonable relation to the State's legitimate purpose in controlling the gasoline retail market* . . . .

Id. at 124-25 (emphasis added; citations and some punctuation omitted).

Under the Ninth Circuit's decision, however, if an oil company were to bring exactly the same claim, relabeled as a "substantially advance" takings claim, a federal court would be compelled to accord the State's "authority to legislate against . . . injurious practices" no weight whatsoever. Under the "substantially advance" test, the Maryland statute, like Act 257 in this case, could well be invalidated as an unconstitutional taking if the judge disagreed with the economic reasoning on which it was based. This strange result strongly indicates that the Ninth Circuit's decision is far astray from core principles of judicial review.

B. This Court's Decisions Under The Just Compensation Clause Also Support Deferential Review

1. The Court has spoken only briefly to the standard of review that might apply under the "substantially advance" test – which is hardly surprising given that the Court's takings precedents strongly suggest, if they do not establish, that means-ends analysis is not appropriate under the Just Compensation Clause at all. To the extent the Court has spoken to the issue, however, it has indicated that a deferential standard of review should apply. *Agins*, the origin of this supposed takings test, itself supports a deferential standard. In *Agins*, the Court summarily rejected plaintiffs' challenge to a municipal land use ordinance under the "substantially advance" theory. The Court observed that the California legislature had developed the goal of preserving open space and that such a purpose had "long . . . been recognized as legitimate." 447 U.S. at 261. The Court also concluded that the city's ordinance would advance that goal by controlling "the ill effects of urbanization," without closely examining either the circumstances surrounding

the law's implementation or whether the ordinance would actually achieve its goals. *Id.*[16]

The *Agins* Court's understanding of the "substantially advance" standard as a continuation of normal principles of deferential review of government regulation is confirmed by *Schad v. Borough of Mount Ephraim*, 452 U.S. 61 (1981), decided one year after *Agins*. In discussing the standard applicable to constitutional review of zoning ordinances, the court in *Schad* described *Agins*, like the earlier due process decisions, as simply requiring "rational basis" review: "Where property interests are adversely affected by zoning, the Courts generally have emphasized the breadth of municipal power to control land use and have sustained the regulation if it is *rationally related* to legitimate state concerns . . . ." *Id.* at 68 (emphasis added) (citing, *inter alia*, *Agins* and *Euclid*).

The Court's subsequent decision in *Keystone* – indeed both the opinion for the Court and the dissent – confirm the applicability of a deferential standard in this context. The Court rejected (on the merits, and without examining the validity of the theory of liability) a claim that a Pennsylvania statute effected a taking because it failed to advance substantially a legitimate state purpose. In

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[16] The due process precedents cited in *Agins* also support a deferential standard. In *Nectow*, the Court stated that, "a court should not set aside the determination of public officers . . . unless it is clear that their action has no foundation in reason and is a mere arbitrary or irrational exercise of power having no substantial relation to the public health, the public morals, the public safety or the public welfare in its proper sense." 277 U.S. at 187-88. Likewise, in *Euclid*, the Court held that, to declare an ordinance unconstitutional, the Court must find that provisions "are clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare." 272 U.S. at 395. In operation, these legal formulations support the same deferential standard that the Court applies in due process cases today. *See Dolan*, 512 U.S. at 391 n.8 (citing *Euclid* as a case in which the Court applied its "usual deference to the legislature").

dissent, Chief Justice Rehnquist, commenting on the majority's application of this test, stressed that courts should not review the efficacy of state legislation in determining whether it effects a "taking" under the Just Compensation Clause:

> [O]ur inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation. When considering the Fifth Amendment issues presented by Hawaii's Land Reform Act [in *Midkiff*], we noted that the Act, "like any other, may not be successful in achieving its intended goals. But 'whether *in fact* the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature *rationally could have believed* that the [Act] would promote its objective.'"

480 U.S. at 511 n.3 (quoting *Midkiff*, 467 U.S. at 242) (emphases and ellipses in *Keystone*). In response, the majority was in complete agreement that a deferential standard of review should apply and was in fact being applied in that case:

> We do not suggest that courts have "a license to judge the effectiveness of legislation," . . . or that courts are to undertake "least restrictive alternative" analysis in deciding whether a state regulatory scheme is designed to remedy a public harm or is instead intended to provide private benefits. That a land use regulation may be somewhat overinclusive or underinclusive is, of course, no justification for rejecting it. *See Euclid* . . . .

480 U.S. at 487 n.16 (citation edited).

2. The Ninth Circuit made several attempts to dismiss the significance of these takings precedents, none of which withstands scrutiny. First, the Ninth Circuit discounted the opinions in *Keystone*; it reasoned that, because Chief Justice Rehnquist referred to *Midkiff*, which

dealt with the requirement of a "public use," the discussion in *Keystone* was irrelevant to the standard of review that applies in deciding whether there has been a "taking." *See* Pet. App. 15, 59-60. That reading of the opinions in *Keystone* is simply wrong; *Keystone* itself involved a claim under the "substantially advance" theory.[17] Whether or not Chief Justice Rehnquist or the Court as a whole believed the appropriate standard of review should be borrowed from the public use cases (or was simply the very same standard), the crucial point is that the Court in *Keystone* was debating, and resolving, the appropriate standard to be applied under the "substantially advance" test. If this is a valid takings test, *Keystone* is binding, indeed unanimous, precedent mandating application of a deferential standard of review.

The Ninth Circuit also believed that use of heightened scrutiny in this case was supported by the Court's decisions in *Nollan* and *Del Monte Dunes*, but neither decision supports use of a heightened standard in a case (such as this) challenging general regulatory legislation. As discussed in Part I (pp. 33-35, *supra*), *Nollan* (and *Dolan*) rest on the particularly burdensome nature of conditions mandating that owners grant the public continuous physical access to their property and the special risk posed by imposition of such conditions in ad hoc permit proceedings. That is precisely why *Dolan* framed the issue as an application of the unconstitutional conditions doctrine, *see Dolan*, 512 U.S. at 385, and made clear that the same exacting scrutiny did not apply to legislative measures. *Id.* at 391 n.8.

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[17] The Ninth Circuit's reading of *Keystone* may have reflected its mistaken understanding that the case actually involved a direct exercise of eminent domain. *See* Pet. App. 15 ("[T]he Supreme Court reviews the challenged action in those cases [*Midkiff* and *Keystone*] more deferentially because they involve physical takings.").

The Court's subsequent decision in *Del Monte Dunes* further confirms that the heightened standard applied in exactions cases is confined to that context. The Court limited the scope of *Dolan* (and implicitly *Nollan*), stating that the "rough proportionality" test for exactions did not extend beyond the special context of "land-use decisions conditioning approval of development on the dedication of property to public use." 526 U.S. at 702. Just as *Del Monte Dunes* confined the scope of the exactions tests, it also necessarily confined the scope of the heightened standard used in applying those tests. Thus, the Ninth Circuit was plainly mistaken in thinking that *Nollan*'s use of heightened scrutiny to examine an ad hoc regulatory exaction could support application of the same standard in a case challenging general legislation. And it is most implausible to suggest that *Nollan* overruled, *sub silentio* and less than four months after the decision in *Keystone*, the Court's clearly expressed understandings in *Agins*, *Schad*, and *Keystone* that traditional, deferential judicial review applies to general economic legislation.

The Ninth Circuit nonetheless believed that *Del Monte Dunes* supports heightened scrutiny, but that reading is clearly mistaken. The Ninth Circuit viewed the Court's decision in *Del Monte Dunes* as having approved jury instructions that defined a government action as substantially advancing a legitimate public purpose if it "bears a reasonable relationship" to that objective. Pet. App. 14. But the Court quite clearly made no holding about the validity of the jury instructions in *Del Monte Dunes*, because the city itself proposed the instructions and therefore waived any possible objection to their substance. 526 U.S. at 704. Moreover, by expressly limiting the *Dolan* standard to exactions, the Court in *Del Monte Dunes*, if anything, cast doubt on the propriety of applying a heightened standard of review outside the exactions context. *See id.* at 702-03. *See also* p. 35, *supra*.

Nor, in any event, is there any basis for the Court of Appeals' conclusion that the phrase "reasonable relationship" in the jury instructions reviewed in *Del Monte Dunes* referred to a heightened standard of review. A "reasonable relationship" inquiry is often regarded as equivalent to the rational basis test. *See, e.g., Turner v. Safley*, 482 U.S. 78, 93 n.* (1987) (defining the rational-basis test as "whether the regulation is reasonably related to a legitimate governmental interest"); *see also Dolan*, 512 U.S. at 391 (noting similarity of "reasonable relationship" and "rational basis" language); BLACK'S LAW DICTIONARY 1290 (8th ed. 2004) (defining the "rational basis test" as an inquiry about whether a law "bears a reasonable relationship to the attainment of a legitimate governmental objective"). While the Court was aware in *Dolan* that some state courts had used the same terminology to denote an elevated standard of review, *see* 512 U.S. at 390, nothing in *Del Monte Dunes* connects the jury instructions in that case to those state court decisions. Thus, from all that can be discerned, use of this phrase in the jury instructions in *Del Monte Dunes* denoted a deferential standard of review.

3. Finally, there remains the contention that, by using the term "substantial" in *Agins*, the Court *necessarily* intended to require heightened scrutiny of the means-ends fit of state economic regulation (even though the Court itself has not done so in later cases). The word "substantial," however, is ambiguous and does not inevitably carry that connotation. *See Pierce v. Underwood*, 487 U.S. 552, 564-65 (1988) (noting that the word "substantial" can have "almost contrary" connotations). "Substantial," when used in this context, often means "nontrivial" rather than "weighty." For example, in *Nebbia v. New York*, 291 U.S. 502 (1934), one of the Court's New Deal decisions that repudiated intrusive review of state economic regulation, the Court referred to the proper standard of review under the Due Process Clause as "real and substantial relation," *id.* at 525, and the Court itself clearly applied deferential

scrutiny. Later in that decision, the Court also phrased the due process test in terms of a "reasonable relation to a proper legislative purpose," *id.* at 537, suggesting that "substantial" is equivalent to "reasonable" – which is itself often used as a substitute for "rational" (*see* p. 47, *supra*). This is not to suggest that the phrase "substantially advance" *cannot* be used to describe a heightened standard of review. But nothing in *Agins* suggests that, by using the word "substantial" in passing, this Court intended (again assuming it established a takings test at all) to launch the lower courts on a far-reaching venture of scrutinizing state (and federal) legislation for conformity to economic theory.[18]

[18] In a footnote in *Nollan*, the Court remarked:

> We have required that the regulation "substantially advance" the "legitimate state interest" sought to be achieved, *Agins v. Tiburon*, 447 U.S. 255, 260 (1980), not that "the State *'could rationally have decided'* that the measure adopted might achieve the State's objective. . . . [T]here is no reason to believe (and the language of our cases gives some reason to disbelieve) that so long as the regulation of property is at issue the standards for takings challenges, due process challenges, and equal protection challenges are identical. . . .

483 U.S. at 835 n.3 (citations edited). This tentative statement is far from an assertion that the word "substantially," by itself, mandates application of heightened scrutiny, and it certainly does not represent a holding that this word supports a heightened standard of review in takings cases outside the exactions context. To the contrary, the Court suggested that the word "substantially" has particular, if not exclusive, salience in exactions cases. *See id.* at 841 ("We are inclined to be particularly careful about the adjective ["substantial"] where the actual conveyance of property is made a condition to the lifting of a land-use restriction, since in that context there is heightened risk that the purpose is avoidance of the compensation requirement, rather than the stated police-power objective."). Fairly read, the quoted passage simply indicates that the wording in the Court's prior takings cases was sufficiently capacious to permit use of heightened scrutiny where such a standard was independently justified, as with exactions. It does not mandate application of heightened scrutiny to general legislation not

(Continued on following page)

* * *

To resolve this case, the Court should simply reaffirm fundamental principles of judicial review of state economic legislation. Unless economic regulation is shown to be arbitrary and irrational, or directed at aims that are not the legitimate province of government, the courts have no warrant to reweigh the evidence about the wisdom or efficacy of a measure adopted by a state legislature. As this Court stated in *Ferguson v. Skrupa*, 372 U.S. 726 (1963):

> We have returned to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws. . . . We are not concerned . . . with the wisdom, need, or appropriateness of the legislation. Legislative bodies have broad scope to experiment with economic problems, and this Court does not sit to subject the state to an intolerable supervision hostile to the basic principles of our government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to secure.

Id. at 730-31 (citations, punctuation, and footnotes omitted).

involving exactions, where the justifications for elevated scrutiny do not exist, as the Court's decisions issued both prior to and subsequent to *Nollan* confirm.

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

Respectfully submitted,

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ACT 257

HOUSE OF REPRESENTATIVES
NINETEENTH LEGISLATURE, 1997
STATE OF HAWAII

H.B. NO. 1451
H.D. 1
S.D. 1
C.D. 1

A BILL FOR AN ACT

RELATING TO THE PETROLEUM INDUSTRY.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. **Legislative findings and declarations**. The legislature reiterates its findings and declarations of section 1 of Act 291, Session Laws of Hawaii 1991, that:

(1) The petroleum industry is an essential element of Hawaii's economy and is therefore of vital importance to the health and welfare of all people in the State of Hawaii;

(2) A complete and thorough understanding of the operations of the petroleum industry is required by the state government at all times to enable it to respond to possible shortages, oversupplies, and other market disruptions or impairment of competition;

(3) Information and data concerning all aspects of the petroleum industry, including, but not limited to, crude oil production, supplies, refining, product output, prices, distribution, and demand are essential for the State to develop and administer energy policies which are in the interest of the State's economy and the public's well-being;

(4) Because Hawaii is a physically small and geographically remote economy, certain of its

markets tend to be concentrated. Market concentration is a function of the number of firms in the market and their respective market shares. In a highly concentrated market, market prices tend to rise above competitive levels. Market prices persistently above competitive levels are harmful to consumers and the public. Barriers to competition tend to cause supracompetitive prices to persist; and

(5) The markets for oil and oil products in Hawaii are highly concentrated markets.

* * *

SECTION 3. Chapter 486H, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

§ 486H- Restrictions on manufacturers or jobbers in operating service stations; lease rent controls; definitions. (a) Beginning August 1, 1997, no manufacturer or jobber shall convert an existing dealer operated retail service station to a company operated retail service station; provided that nothing in this section shall limit a manufacturer or jobber from:

(1) Continuing to operate any company operated retail service stations legally in existence on July 31, 1997;

(2) Constructing and operating any new retail service stations as company operated retail service stations constructed after August 1, 1997, subject to subsection (b); or

(3) Operating a former dealer operated retail service station for up to twenty-four months until a replacement dealer can be found if the former dealer vacates the service station, cancels

the franchise, or is properly terminated or not renewed.

(b) No new company operated retail service station shall be located within one-eighth mile of a dealer operated retail service station in an urban area, and within one-quarter mile in other areas. For purposes of this subsection, "urban" means the first congressional district of the State, and "other areas" means the second congressional district of the State.

(c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:

(1) Such renewal shall not be scheduled more frequently than once every three years; and

(2) Upon renewal, the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen per cent of the gross profit of product, excluding all related taxes by the dealer operated retail service station as defined in section 486H-1 and 486H- plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purposes of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail service station after all applicable taxes, excluding income taxes, are paid.

The provisions of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.

(d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.

(e) For the purposes of this section:

"Company operated retail service station" means a retail service station owned and operated by a manufacturer or jobber and where retail prices are set by that manufacturer or jobber.

"Dealer operated retail service station" means a retail service station owned by a manufacturer or jobber and operated by a qualified gasoline dealer under a franchise.

"Operate" means to engage in the business of selling motor vehicle fuel at a retail service station through any employee, commissioned agent, subsidiary company, or person managing a retail service station under a contract and on a fee arrangement with the manufacturer or jobber.

"Retail" means a sale of gasoline made to the general public at prices that are displayed on the dispensing equipment."

SECTION 4. Chapter 486E, Hawaii Revised Statutes, is repealed.

SECTION 5. Chapter 486I, Hawaii Revised Statutes, is repealed.

SECTION 6. Chapter 486H-10, Hawaii Revised Statutes, is repealed.

["**§ 486H-10 Prohibition of manufacturer or jobber from operating a service station.** (a) From July 31, 1993, to August 1, 1997, no manufacturer or jobber shall operate a major brand, secondary brand, or unbranded retail service station in Hawaii to sell its petroleum products; provided that for each dealer operated retail service station owned by a manufacturer or jobber opened on or after July 31, 1995, that manufacturer or jobber may open one company operated retail service station, up to a maximum of two company owned retail service stations.

For purposes of this subsection:

"Company operated retail service station" means a retail service station owned and operated by a manufacturer or jobber.

"Dealer operated retail service station" means a retail service station owned by a manufacturer or jobber and operated by a qualified gasoline dealer.

(b) For the purposes of this section, the term "to operate" means to engage in the business of selling motor vehicle fuel at a retail service station through any employee, commissioned agent, subsidiary company, or person managing a retail service station under a contract and on a fee arrangement with the manufacturer or jobber.

(c) This section shall not apply to any individual locations operated by any manufacturer or jobber on the effective date of this Act. Nor shall anything contained in this section prohibit a manufacturer or jobber from acquiring or constructing replacement retail service stations to replace any company-operated retail service stations in

existence on July 30, 1993, that have subsequently closed due to the expiration or termination of the retail service station's ground lease; provided that:

(1) The manufacturer or jobber shall negotiate in good faith to renew the ground lease of the retail service stations; and

(2) The replacement retail service stations shall be located within a one-mile radius of the retail service stations that they replace.

As used in this subsection, "good faith" means an honest and sincere intention to renew the ground lease of retail service stations."]

SECTION 7. If any provision of this Act, or the application thereof to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are severable.

SECTION 8. Statutory material to be repealed is bracketed. New statutory material is underscored.

SECTION 9. This Act shall take effect on August 1, 1997.

APPROVED this 21st day of June, 1997

/s/ Benjamin J. Cayetano
GOVERNOR OF THE STATE OF HAWAII

Supreme Court, U.S.
FILED
JAN 14 2005
OFFICE OF THE CLERK

No. 04-163

IN THE

Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON U.S.A. INC.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENT

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QUESTIONS PRESENTED

1. Whether a regulation that deprives respondent of a specific property interest (the right to collect market rents from real property) without compensation effects a taking in violation of the Just Compensation Clause when there is no contention that the rents prohibited by the regulation are or would be the source of any problem the regulation seeks to address.

2. Whether the Just Compensation Clause requires nothing more than the "mere rationality" review applied under the Due Process Clause, or whether, as this Court has repeatedly held, meaningful scrutiny is required to protect interests expressly guaranteed by the Just Compensation Clause.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of this Court's rules, respondent Chevron U.S.A. Inc. ("Chevron") incorporates by reference the disclosure statement in its opposition to the petition for *certiorari*.

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STATEMENT OF THE CASE

Chevron (like its competitors) markets gasoline in Hawaii through several different distribution avenues. One is to sell directly to consumers through service stations the company itself owns and operates. Another is to sell to dealers who own their stations (so-called "open" dealers). A third is to sell to lessee dealers, who lease their service stations from Chevron.

The State has decided that Hawaii consumers will benefit if lessee dealers remain in business. It is at least debatable whether it makes sense to favor lessee dealers over other distribution avenues, but the wisdom of the State's choice is not at issue here. Instead, the question is whether the State can attempt to implement its policy by requiring Chevron to forgo rents, when even the State does not claim the rents have been the source of any problem the State is seeking to address.

A. Act 257 and the State's Asserted Purposes

The Hawaii Legislature enacted Act 257 in 1997. The stated purpose of the act is to combat the effects of alleged concentration in the Hawaii market for gasoline, which the Legislature said was resulting in higher gasoline prices and hurting consumers and the public. Pet. Br. App. 1-2. The act seeks to accomplish this goal by, among other things, dictating the maximum rent Chevron and other oil companies may collect under their agreements with lessee dealers. Rent is capped at 15% of the dealer's profit on gasoline sales plus 15% of the dealer's gross sales on products other than gasoline, plus (where applicable) a percentage increase equal to any increase the oil company is required to pay on its ground lease. Pet. App. 122.

For eleven of Chevron's lessee-dealer stations in Hawaii, the statute requires that Chevron reduce the rent it would otherwise collect by as much as 45%.[1] These rents are payable to Chevron under lease agreements Chevron enters with its lessee dealers as consideration for the dealer's right to occupy Chevron's service station premises. Chevron makes the entire investment in these stations: it purchases or leases the land and bears the entire expense of building the station. JA 37. Under the leases, Chevron bears the ongoing property expenses, including the ground lease rents, real property taxes, and ordinary maintenance expenses (subject to certain terms of the lease). *Id.*[2]

Although the State's asserted purpose in enacting Act 257 was to combat market concentration, it is undisputed that the Hawaii retail market in which lessee dealers operate is highly unconcentrated. Gasoline is sold at retail in Hawaii from about 300 different service stations. Trial Tr. 95:22. Nearly half of these are lessee-dealer stations, and another 75 or so are open dealers. *Id.* at 92:14-94:9. Chevron's own dealer network is even more heavily skewed toward lessee dealers and open dealers. Chevron operates only 6 of its own stations in Hawaii, while selling to 64 lessee-dealer stations and 6 open dealers. JA 45-47, 117-18.[3] The State's expert

[1] The total rent taken by Act 257 from the eleven stations was stipulated to be about $207,000 per year. JA 45-47.

[2] At each of its stations, Chevron also earns revenues from selling gasoline under a separate supply agreement. JA 37-38. As the State notes, when that source of revenue is included, Chevron has stipulated that its total return on its service station investments is sufficient to satisfy constitutional standards. JA 40. The State correctly does not contend, however, that Chevron's ability to earn revenue from selling other products permits the State to take Chevron's rent.

[3] Other companies are similar. Shell sold to 35 lessee dealers and 17 open dealers, with no company-operated stations. Trial Tr. 93:17-21. Unocal had only three company-operated stations, compared to 29 lessee dealers and 13 open dealers. *Id.* at 93:12-16. Texaco had roughly the same number of lessee-dealer stations and company-operated stations. *Id.* at 93:22-24. Only two smaller wholesalers had opted not to do business largely through lessee-dealer stations. *Id.* at 93:25-94:9. This includes Aloha, the only Hawaii-based wholesaler, which had 16 company-operated stations and just one lessee-dealer station and which is thus largely, if not entirely, unaffected by Act 257. *Id.* at 94:3-9.

witness admitted that, by any measure, this retail market in Hawaii is "very unconcentrated" and "highly competitive." JA 118. As he testified, "the market is already overbuilt with stations or oversupplied with stations." JA 122.

Given this evidence, the State does not claim that the rents Chevron or other oil companies have charged in Hawaii have been too high or are otherwise the source of any adverse market condition. If anything, the opposite is true. Not only has an extensive lessee-dealer network developed under the rents that Chevron and others have been collecting, but the State stipulated below that Chevron's rents have been below that necessary for Chevron to recoup its expenses associated with lessee-dealer stations. JA 40. Rents have thus been set at levels to induce more, rather than fewer, lessee dealers to do business with Chevron. As the State's expert testified, it would be simply "not true" to assert that "Chevron is charging excessive rents in Hawaii" in an effort "to drive [its] lessee-dealers out of business." Trial Tr. 105:19-25.[4]

It was also undisputed below that the rents Chevron and others have been charging—and that are now prohibited by Act 257—have not caused high retail gasoline prices. The State's expert identified several factors contributing to

[4] Nor can it be said the total economic package Chevron is offering to dealers makes their existence unprofitable. As the State stipulated and its expert admitted, that package has been sufficiently attractive that incumbent dealers have been able to sell their dealership rights (including the leasehold interest and obligation to pay rent) to new dealers for amounts of up to $500,000. JA 42; Trial Tr. 106:1-14.

allegedly high gasoline prices in Hawaii, including concentration at the *wholesale* level, relatively high State gasoline taxes, and high entry barriers at the wholesale level. JA 120-26. He testified, however, that rent charged to lessee dealers was not one of these factors. JA 126. The State makes no claim otherwise.

The State likewise does not claim that the forced reductions in rent that Act 257 imposes will cause lessee dealers to lower their retail gasoline prices to consumers. As the State acknowledged to the district court, "[b]oth [parties'] economists agree that as a matter of economic principle, this will not happen. If the dealer has money in his pocket [from a rent reduction], it is not expected that he will hand it over to the consumer in the form of lower prices." Def's Final Written Arg. (filed 3/8/02), p. 2 (Supp. ER 41).

In fact, the evidence at trial established, and the district court found, Pet. App. 40-41, that the likely effect of the rent cap would be to cause retail gasoline prices to *increase*. Faced with the lost revenue from the rent cap, oil companies would likely seek to recoup that revenue by increasing their wholesale gasoline prices. JA 153-54. And both sides' experts testified that the price consumers pay for gasoline would increase if the oil companies did so. JA 119, 135-36, 151. The State's expert suggested that the competitive market for gasoline sales would not allow the oil companies to sustain any wholesale price increase and that the oil companies would therefore be unable to recoup the lost rent. JA 98-99. If that were the case, however, both experts agreed that the effect of the forced reduction in overall revenues from lessee-dealer stations would be to penalize investment in such stations and reduce the oil companies' incentive to make such investments, JA 55, 138, 143, 148—precisely the opposite of the goal the State says it is seeking to achieve.

Moreover, to the extent that the oil companies are not able to recover the lost rent, the State conceded that the effect will

be to cause the value of the dealer's leasehold to increase. JA 136-37. That increased value would, on average, equal the present value of the reduced rent and would result in a premium that the lessee dealer could realize upon sale of the leasehold. *Id.* (Unlike residential renters, lessee dealers have a statutory right to renew their lease agreements and the right to transfer the leasehold. JA 40-41.)

But regardless of whether the act would actually cause retail gasoline prices to increase or lead to reduced investment in lessee-dealer stations, it remains uncontested that the rents Chevron has charged its lessee dealers have not been the cause of any adverse market effects and that the rent reduction forced by Act 257 will simply be captured by the dealers and will not cause them to lower prices to consumers.

Faced with these uncontroverted facts, the State asserts not that the Legislature was motivated by any extant problem caused by rents charged to dealers, but instead that it enacted Act 257 to "maintain the benefit" of a "multiplicity of independent lessee-dealerships" that has existed under the rents that Act 257 would prohibit Chevron from charging. Pet. Br. 2. It says the statute was passed to "forestall" the "possibility that oil companies might try" at some future date to "rais[e] rents to the point that existing dealers would be forced out of business." *Id.* at 3. According to the State, if that were to occur, the result would be an "oligopolistic concentration in the retail market" mirroring that allegedly existing in the wholesale market, leading to higher gasoline prices for consumers. *Id.* at 2.

The State does not contend that Chevron or any other oil company has engaged in such rental practices in Hawaii. The "multiplicity of independent lessee-dealerships" that the State admits exists in Hawaii belies any such contention. The State has never explained why Chevron would contract with lessee dealers only to drive them out of business and replace them with company-owned stations that it chose not to establish in the first place. Indeed, the State's expert (on

whose testimony the State relies as establishing the purposes and bases for Act 257) testified that he was not aware of any evidence that Chevron or other oil companies were trying to use excessive rents to drive lessee dealers in Hawaii out of business. Trial Tr. 162:11-163:2.

But even if Chevron might someday try to use rent increases to run lessee dealers in Hawaii out of business (and even if the possibility of such future conduct were sufficient to justify taking Chevron's property), the State does not contend that the rents the State stipulated Chevron would collect under its lease agreements absent Act 257, *see* JA 38, 45-47, have had or ever would have that effect. Indeed, the statute freezes rents at a level *below* that necessary for Chevron to recoup its expenses associated with its lessee-dealer stations in Hawaii. JA 38.

Act 257 was unaccompanied by any legislative findings supporting the rationale advanced in the State's brief. There was no determination, for example, that the rents charged to dealers were the cause of any concentration in the Hawaii market, that such rents caused, or might cause in the future, higher prices to consumers, or that capping rents would hold down gasoline prices. The State introduced no evidence below that the Legislature had conducted any hearings or compiled any evidence on these issues.

B. The Decisions Below

Chevron brought suit in federal district court in Hawaii seeking a determination that Act 257 effects an uncompensated taking in violation of the Fifth Amendment. The parties initially submitted the case to the court on stipulated facts and cross-motions for summary judgment. The court (Judge Kay) granted Chevron's motion for summary judgment, holding that the statute would not substantially advance its purposes but would instead merely create a premium in the value of the leases that incumbent dealers could capture when transferring the leasehold. Pet. App. 94-118.

On appeal, the Ninth Circuit held that the district court had applied the proper legal standard in requiring that the statute substantially advance a legitimate government interest. *Id.* at 58-66. It held that the substantially advances test in this context requires that a "reasonable relationship" exist between the legislation and the goals it was designed to advance. *Id.* at 76. Nonetheless, it held that the district court had "short-circuited the fact-finding process" under that standard by resolving the issue without a trial. *Id.* at 72.

On remand, after additional discovery and a one-day bench trial, the district court (Judge Mollway) ruled that Act 257 effected an uncompensated taking in violation of the Just Compensation Clause. *Id.* at 30-53. Relying on the State's own concessions and the undisputed evidence, the court found that rents charged to lessee dealers have not been the cause of high retail gasoline prices in Hawaii, that dealers would not pass along any rent reductions to consumers in the form of lower gasoline prices, and that there was no evidence that oil companies were likely to try to eliminate lessee dealers by charging excessive rent. *Id.* at 40, 44. It also found that, rather than decreasing gasoline prices in Hawaii or forestalling future price increases, the "direct effect of Act 257 will actually be to cause retail gasoline prices to increase." *Id.* at 44, ¶ 31. The court also found that, even in the absence of price increases, oil companies would "avoid investing in new and existing lessee-dealer stations," leading to "fewer lessee-dealer stations than there would be without Act 257." *Id.* at 49, ¶ 49.

The Ninth Circuit affirmed. *Id.* at 24. It reiterated its holding from its earlier decision that the substantially advances test is a valid takings test. *Id.* at 6-13. It also repeated its previous holding that the intermediate "reasonable relationship" standard is the proper requirement for satisfying the substantially advances test in this context. *Id.* at 13-17. The court determined that the facts found by the district court were not clearly erroneous and supported

the judgment for Chevron under the foregoing legal standards. *Id.* at 17-24.

Judge Fletcher dissented. He did not dispute the continuing validity of the substantially advances test. To the contrary, he acknowledged that it is a "test ordinarily applied to zoning and other land use regulations." *Id.* at 25. Moreover, he agreed with the majority that "[t]he evidence put on by the State's expert in support of Act 257 was sufficiently weak, and the countervailing evidence put on by Chevron's expert was sufficiently strong, that the district court did not err in concluding that th[e substantially advances] test was not satisfied." *Id.* at 26. Nonetheless, Judge Fletcher opined that the substantially advances test does not extend to rent-control legislation unless it is shown that the legislation will necessarily allow the incumbent lessee to collect a premium upon transfer of the leasehold interest, a showing that Judge Fletcher believed had not been made. *Id.* at 26-29.

SUMMARY OF ARGUMENT

For over eighty years, this Court has recognized that the Just Compensation Clause extends to deprivations of discrete property interests imposed by regulation. At the same time, recognizing the government's need to advance its legitimate purposes, the Court has ruled that not all regulatory burdens on property require compensation and that a critical factor in determining when compensation is owed is the character of the government's action. This central focus on the nature of the government's action both flows from the rationale for permitting uncompensated takings by regulation and serves the core purpose of the Just Compensation Clause of preventing the government from unfairly concentrating the burdens of regulation on individual property owners.

The Court's substantially advances test, repeatedly recognized by this Court for over twenty-five years, is a vehicle by which the Court isolates those circumstances in which the character of the government's action requires

compensation. As a contemporary statement of the Court's "noxious use" cases, the substantially advances test focuses on whether the government has improperly singled out individual property owners whose property is not the source of the social condition the government is seeking to address. The test similarly asks whether the government is burdening individual property rights in ways that will not address the problem at issue. Where these circumstances are present, the rationale for permitting deprivations of property rights without compensation is absent and the Just Compensation Clause requires the government to pay for the deprivation should it wish to proceed. The State's argument that the only inquiry in a regulatory takings case is the severity of the regulation's economic impact, or that any inquiry beyond that must be conducted only under deferential due process standards, would improperly eliminate this fundamental inquiry from takings analysis.

The substantially advances test is distinct from the inquiry under the Due Process Clause, in both its purposes and its consequences. It focuses on the fairness of singling out individual property owners for particular burdens, not on the general wisdom or utility of legislation. It implements an express prohibition in the Bill of Rights and is limited to specific rights of "private property." Unlike due process review, it does not bar the government from acting, but rather permits governmental action conditioned on compensation to ensure that the burdens of regulation are fairly distributed. The State's argument that enforcing the requirements of the Just Compensation Clause will herald a return of intrusive *Lochner*-era substantive due process review is thus unfounded. The vice of *Lochner* review was that it permitted courts to invalidate laws in the absence of a specific constitutional prohibition. Enforcing the explicit guarantee of the Just Compensation Clause to further its specific purposes involves no such review, any more than does this Court's enforcement of any of the other specific protections found in the Bill of Rights.

Consistent with its distinct purposes and consequences, the Just Compensation Clause requires more than mere rationality. Instead, it requires meaningful scrutiny of the purposes and effects of the government's action. Contrary to the State's argument, meaningful review does not mean that no deference is to be given to legislative judgments. It does require, however, that the government have made reasonable judgments on the relevant issues and that those conclusions be supported by actual evidence. Here, there is no indication that the Legislature undertook any investigation or gathered any evidence. The statute is unaccompanied by any legislative findings that the rents charged to lessee dealers are the source of any problem or that the rent caps imposed by Act 257 could be a solution. Nor is there evidence supporting any such conclusions. The only effect of the statute is to appropriate and transfer to lessee dealers a valuable property interest belonging to Chevron. No principle of deference is violated by holding that this statute effects a taking absent just compensation.

ARGUMENT

I. LAND-USE REGULATION THAT DOES NOT SUBSTANTIALLY ADVANCE A LEGITIMATE STATE INTEREST IS INVALID ABSENT JUST COMPENSATION

This Court has repeatedly recognized, in cases spanning more than a quarter of a century, that land-use regulation that does not "substantially advance" a legitimate state interest is invalid under the Fifth Amendment unless just compensation is paid. The first express articulation of the test occurred in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), where the Court found it "implicit" in earlier cases that an interference with property rights "may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose." *Id.* at 127. Two years later, in *Agins v. Tiburon*, 447 U.S. 255 (1980), the Court expressly held that legislation interfering with

property rights must "substantially advance legitimate state interests" to withstand a Just Compensation Clause challenge, and the Court applied that requirement in upholding challenged zoning ordinances. *Id.* at 260.

The Court has since reiterated the availability of the substantially advances test in a long line of cases. *See Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 333-34 (2002) (noting that property owner could have made the argument that non-exaction land-use restrictions "did not substantially advance a legitimate state interest" to support a taking claim); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 704 (1999) (noting that jury instruction requiring "that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions" was "consistent with our previous general discussions of regulatory takings liability"); *Dolan v. City of Tigard*, 512 U.S. 374, 385 (1994) ("A land use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests'" (quoting *Agins*, 447 U.S. at 260)); *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1016 (1992) (noting that the Court had recognized the validity of the substantially advances test "on numerous occasions"); *Yee v. City of Escondido*, 503 U.S. 519, 530 (1992) (noting that there must be "a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance"); *Nollan v. Cal. Coastal Comm'n*, 483 U.S. 825, 834 (1987) ("We have long recognized that land-use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests'" (quoting *Agins*, 447 U.S. at 260)); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 485 (1987) (describing the substantially advances requirement as an "integral part[] of our takings analysis"); *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985) (noting that the substantially advances test represents part of "our general approach" in takings cases); *see also San Diego Gas & Elec. Co. v. San Diego*, 450 U.S. 621, 647 (1981) (Brennan, J.,

dissenting) (describing *Agins* as a "clear precedent[] of this Court" establishing that a land-use regulation "effects a taking if the ordinance does not substantially advance legitimate state interests").

These cases recognize the applicability of the test in taking cases generally, and not just to certain narrow kinds of regulatory burdens on property rights. *See, e.g., Tahoe-Sierra*, 535 U.S. at 333-34 (development moratorium); *City of Monterey*, 526 U.S. at 703-04 (denial of permit); *Yee*, 503 U.S. at 530 (rent control); *Dolan*, 512 U.S. at 385 (permit condition); *Nollan*, 483 U.S. at 835-36 (permit condition); *Keystone*, 480 U.S. at 476-77 (statutory restriction on mining operations); *Agins*, 447 U.S. at 260 (zoning ordinance).

The State's position is that these decisions were all an inexplicable mistake—a product of "uncertainty" and "confusion," Pet. Br. 28, regarding the meaning of the Just Compensation Clause. According to the State, the existence of a regulatory taking turns "largely, if not exclusively, on a regulation's economic impact," *id.* at 15, thus rendering irrelevant the relationship between the regulation's purposes and the burden it imposes, or the degree to which the regulation unfairly singles out individual property owners by imposing burdens unrelated to any harm they have caused. In the State's view, all such issues are properly considered, if at all, only under the Due Process Clause.

This Court's precedents have consistently rejected such efforts to drain the Just Compensation Clause of independent meaning in the regulatory takings context. The Court should reaffirm those precedents. As we show in the following sections, the substantially advances requirement flows from, and gives effect to, the core purpose of the Just Compensation Clause of ensuring that regulatory burdens are not unfairly concentrated on discrete property owners. Indeed, the very premise of permitting the government to take away certain property interests through regulation without paying compensation is that the government must be

granted that power to accomplish its legitimate purposes. The State seeks now to retain that power divorced from the circumstance justifying its exercise.

A. The Character of the Government's Action Has Been a Fundamental Part of This Court's Regulatory Takings Jurisprudence for Over Eighty Years

The Fifth Amendment provides that "private property [shall not] be taken for public use, without just compensation." The State does not dispute that Chevron's right to rent for the occupation and use of its service station premises is "private property" within the meaning of this provision. Indeed, it is a real property interest.[5] Nor can there be any dispute that Act 257 deprives Chevron of that property when it prevents Chevron from collecting the rents it would otherwise be entitled to collect under its contracts with lessee dealers.

Since at least *Pennsylvania Coal v. Mahon*, 260 U.S. 393 (1922), this Court has recognized that such deprivations of private property fall within the Fifth Amendment's

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[5] Rent is paid for the use and enjoyment of land and issues from the profits of the estate. 1 Milton R. Friedman, *Friedman on Leases* § 5.101 (4th ed. 1997); 2 William F. Walsh, *Commentaries on the Law of Real Property* §§ 177-78 (1947). Because rent issues out of the land, rent is an incorporeal interest in property. 2 *American Law of Property* § 9.41 (A. James Casner ed., 1952); Walsh, *supra*, § 177. For that reason, the right to future, unaccrued rents is real property. Casner, *supra*, § 9.41; 1 George W. Thompson, *Commentaries on the Modern Law of Real Property* § 240 (1924) (Rents "are an incident to the reversion and follow the land. They pass with a sale or devise of the land. . . . In fact, although separable from the reversion, they are, until such separation, part of the land."). Hawaii law is in accord. *See Smith v. Smith*, 535 P.2d 1109, 1115-16 (Haw. 1975) ("[T]he right to rent to accrue on a lease for the use or occupancy of real property is an incorporeal hereditament and is an incident to an estate in land, the transfer of which is a transfer of an interest in realty.").

protection, even though they are accomplished by regulation rather than by direct governmental condemnation. As this Court recognized in *Lucas*, this reading of the Fifth Amendment is consistent with its text, which refers to taking property rather than condemning it, and which differs from the more limited text Madison originally proposed. *Lucas*, 505 U.S. at 1028 n.15.[6] It is also consistent with the fact that regulation can destroy property rights no less than direct appropriation. *See San Diego Gas & Elec.*, 450 U.S. at 652 (Brennan, J., dissenting) ("Police power regulations such as zoning ordinances and other land-use restrictions can destroy the use and enjoyment of property in order to promote the public good just as effectively as formal condemnation or physical invasion of property."). Indeed, because the destruction of property rights through regulation is typically less "obvious and undisputed" than when the government condemns or physically appropriates property, *Tahoe-Sierra*, 535 U.S. at 322 n.17, regulation often carries with it a greater threat of uncompensated deprivation of constitutionally protected property interests than outright appropriation. As the Court observed in *Mahon*, if taking of property through regulation were broadly permitted, "the natural tendency of human nature [would be] to extend the qualification more and more until at last private property disappears." 260 U.S. at 415.

Although holding that "regulatory" takings fall within the Fifth Amendment, *Mahon* also recognized that the government's need to accomplish its legitimate purposes qualifies the protection otherwise afforded by the Fifth Amendment's unqualified text. As the Court stated, "[g]overnment could hardly go on if to some extent values incident to property

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[6] *See generally* Andrew Gold, *Regulatory Takings and Original Intent: The Direct, Physical Takings Thesis "Goes Too Far,"* 49 Am. U.L. Rev. 181 (1999).

could not be diminished without paying for every such change in the general law." *Id.* at 413. Thus, the Court concluded, an "implied limitation" on the Just Compensation Clause exists to permit the government to validly exercise its police power. The Court cautioned, however, that "obviously the implied limitation must have its limits, or the contract and due process clause are gone." *Id.*

Consistent with *Mahon*'s basic premise that it is the government's need to achieve its legitimate purposes that permits an exception to the rule of compensated takings, this Court's regulatory takings cases have consistently focused on the strength of the government's interest in determining whether compensation is required.

In *Penn Central*, the Court held that, "[i]n deciding whether a particular governmental action has effected a taking, this Court focuses . . . both on the character of the action and on the nature and extent of the interference with rights in the parcel." 438 U.S. at 130-31. Thus, the Court recognized that "a use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose." *Id.* at 127. Central to the Court's conclusion in that case that the landmark preservation law did not work a taking was its recognition that the law served "an entirely permissible governmental goal" and that the restrictions it imposed were an "appropriate means of securing th[ose] purposes." *Id.* at 129. The Court further concluded that the law had not "singl[ed] out individual landowners for disparate and unfair treatment." *Id.* at 132. It was only after finding on the basis of these conclusions that the character of the government's action did not invalidate the law that the Court separately analyzed whether the law independently worked a taking because of the "severity of the impact of the law on appellants' parcel." *Id.* at 136.

This Court's other regulatory takings decisions have likewise recognized that the character of the government's

action is a critical determinant of whether compensation is required. *See Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 163 (1980) (regulation may restrict property uses "if such public action is justified as promoting the general welfare"); *Palazzolo v. Rhode Island*, 533 U.S. 606, 627 (2001) (a taking may occur when "a particular exercise of the State's regulatory power is so unreasonable or onerous as to compel compensation"); *id.* at 634 (O'Connor, J., concurring) ("The purposes served, as well as the effects produced, by a particular regulation inform the takings analysis."); *Lucas*, 505 U.S. at 1071 (Stevens, J., dissenting) ("the first and, in some ways, the most important factor in takings analysis [is] the character of the regulatory action"); *Hodel v. Irving*, 481 U.S. 704, 716 (1987) (finding a regulatory taking based on the "character of the Government regulation," including that it burdened property rights in ways more broad than necessary and ways counterproductive to the government's goals); *Keystone*, 480 U.S. at 488 ("the nature of the State's interest in the regulation is a critical factor in determining whether a taking has occurred"); *Yee*, 503 U.S. at 530 ("whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance" bears on the existence of a regulatory taking).

The State's argument that the existence of a taking depends "largely, if not exclusively," on the severity of the economic impact, Pet. Br. 15, is irreconcilable with these precedents. In effect, the State seeks a one-way ratchet, under which the nature of the government's interest works only in the government's favor. Under the State's approach, the government is granted the power to burden discrete property interests to advance its legitimate purposes, but no inquiry is permitted into whether the government's action is properly related to those purposes or whether instead "private property is being pressed into some form of public service under the guise of mitigating serious public harm." *Lucas*, 505 U.S. at 1018.

The Just Compensation Clause exists "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960); *see Agins*, 447 U.S. at 260 ("The determination that governmental action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest."). But under the State's approach, no vehicle exists for ensuring that this core constitutional purpose is served. So long as the government can cite some public purpose and has not completely destroyed the property's economic value, the inquiry would be over, without any examination into whether the government has unfairly singled out discrete property owners for burdens that should be borne by the public as a whole. *See Lucas*, 505 U.S. at 1067 (Stevens, J., dissenting) (recognizing that "the risks of such singling out are of central concern in takings law" and that "[a] regulation may single out a property owner without depriving him of all of his property"). This Court's focus on the nature of the government's interest prevents that result.

B. The Substantially Advances Test Furthers Fundamental Just Compensation Clause Purposes by Focusing on the Required Connection Between the Governmental Interest Asserted and the Burden on Property Interests

The requirement that a regulation substantially advance a legitimate state interest stems directly from the foregoing principles. It gives content to the Court's inquiry into the "character of the government's action" and ensures that the fundamental purposes of the Just Compensation Clause are not frustrated.

At the threshold, the substantially advances test focuses on whether the property that is the target of the government's regulatory action is the source of the social evil the

government seeks to remedy. In *Lucas*, this Court recognized that the substantially advances test is the Court's "contemporary statement[]" of its historical recognition that government may burden property rights to prevent a "harmful or noxious use." 505 U.S. at 1023-24. Thus, a baseline requirement of the Court's regulatory takings cases has been that a causal connection exist between the property uses prohibited and the social condition the government seeks to address. A land-use regulation cannot be said to substantially advance a legitimate governmental purpose if it burdens property that has not contributed to the problem at issue or is not distinctively interfering with any solution. Thus, the law that was upheld in *Penn Central* prevented renovations that would destroy the historic character of landmarks. 438 U.S. at 109. In *Agins*, the prohibited development would have frustrated "the city's interest in assuring careful and orderly development of residential property." 447 U.S. at 262. In *Keystone*, the law prevented coal mining that would cause subsidence of the surface. 480 U.S. at 491 (government was acting to "restrain[] uses of property that are tantamount to public nuisances"). In *Nollan*, the Court recognized that the requested development could be denied outright if the Nollans' new house "would substantially impede" the state's purposes. 483 U.S. at 835. And in *Tahoe-Sierra*, the Court observed that a substantially advances challenge to the development moratorium at issue there was foreclosed by the district court's finding that the moratorium "represented a proportional response to a serious risk of harm to the lake" created by the proposed development. 535 U.S. at 334.[7]

[7] This Court's earlier cases are to the same effect. *See, e.g., Goldblatt v. Hempstead*, 369 U.S. 590 (1962) (imposing requirements on sand and gravel excavation activities to prevent destabilization of surrounding properties); *Miller v. Schoene*, 276 U.S. 272 (1928) (requiring removal of cedar trees that were causing damage to adjacent apple trees); *Hadacheck v. Sebastian*, 239 U.S. 394 (1915) (prohibiting operation of a brickyard in a residential neighborhood); *Mugler v. Kansas*, 123 U.S. 623 (1887) (prohibiting use of a building as a brewery).

As *Lucas* discussed, the distinction between regulations that prevent harm and those that confer benefits is "often in the eye of the beholder," 505 U.S. at 1024, and thus the Court's more recent cases analyze the question in terms of the government's police power rather than "noxious use." Similarly, the Court has recognized that the government's police power is not limited to instances of unlawful conduct or "moral wrongdoing." *Id.* at 1023 (quoting *Penn Central*, 438 U.S. at 133 n.30). But the Court has consistently required that the property use at issue be the source of the condition the government is seeking to address.

In some cases, even where such a causal connection exists, the Court has found the law invalid under the more general *Penn Central* balancing test because the burden on property rights was too severe in relation to the governmental interest to be served. *E.g., Hodel v. Irving*, 481 U.S. 704 (1987) (finding a taking even though a causal connection existed between the devising of small, undivided interests in Indian lands and the problem of fractionated ownership Congress sought to correct).

But no such balancing is necessary when, at the threshold, the property taken is not the source of the condition sought to be corrected. In that circumstance, compensation must be paid because no basis exists for requiring the property owner to shoulder the economic burden imposed by the statute. *See Armstrong*, 364 U.S. at 49; *see also Pennell v. City of San José*, 485 U.S. 1, 20 (1988) (Scalia, J., concurring in part and dissenting in part) (traditional land-use regulation satisfies the Just Compensation Clause "because there is a cause-and-effect relationship between the property use restricted by the regulation and the social evil that the regulation seeks to remedy"). By ensuring that governmental action burdens only those property uses that are "the source of the social problem," the causal nexus required by the substantially

advances test prevents a regulated landowner from being "singled out unfairly" by legislation seeking to remedy social problems not attributable to his or her property. *Pennell*, 485 U.S. at 20 (Scalia, J., concurring in part and dissenting in part); *see Nollan*, 483 U.S. at 835 n.4 (discussing application of Just Compensation Clause where property owners are "singled out to bear the burden" of remedying a problem to which they have not contributed more than others); *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 325 (1893) (Just Compensation Clause prevents government from "loading upon one individual more than his just share of the burdens of government").

This case vividly illustrates these dangers. There is no claim that the rents charged to lessee dealers in Hawaii have been the source of high gasoline prices or have impeded any effort by the State to address those prices, let alone any claim that rents have contributed to high gasoline prices more than other factors. Nor is there any contention that rents have contributed to any market concentration. In fact, the opposite is true. There is thus no basis for singling out those rents to shoulder the burden of the State's regulation—and no rationale for permitting the government to take Chevron's property interests without compensation. The State is simply taking the property of Chevron and other out-of-state wholesalers to subsidize the operation of local lessee dealers. Whether or not it is a wise public policy choice to seek to enhance the dealers' fortunes in this fashion, the State may not achieve that goal "by a shorter cut than the constitutional way of paying for the change." *Mahon*, 260 U.S. at 416; *see Keystone*, 480 U.S. at 483 (compensable taking occurs when property is taken "merely to augment the property rights of a favored few") (internal quotation marks omitted).

In describing the substantially advances test as inquiring only into the "effectiveness" of government action, Pet. Br. 17, the State disregards this threshold function of the test in preventing unfair singling out of individual property owners whose property is not the source of the problem being

addressed. By asserting that the only inquiry in a regulatory takings case is the degree of economic impact, or that any inquiry beyond that must be conducted only under deferential due process standards, the State seeks to eliminate this fundamental inquiry from takings analysis, or render it wholly ineffectual. The United States suggests that this singling out issue should be addressed as part of a general balancing under *Penn Central*. U.S. Br. 11 n.2. But it does not explain why, so long as there is a burden on discrete property rights (as there is here), the fact that the government is singling out a property owner who is not the cause of the problem should be merely one "factor" to balance and not sufficient by itself to require compensation. Neither the State nor its amici identify any compensating factor that could justify such an intrusion on protected property rights.

In related fashion, the substantially advances test also serves to identify those cases in which the burden on property rights is not sufficiently related to the purpose to be served. Even where a property use may be the source of a problem, no legitimate basis exists for singling out that property for a special burden if the burden will not contribute to the problem's solution. In that circumstance as well, the rationale for taking property rights without compensation—the government's need to achieve its legitimate purposes—is absent and the core purpose of the Just Compensation Clause in preventing unfair concentration of burdens on discrete property rights is violated. The government is again merely transferring property rights "under the guise of mitigating serious public harm." *Lucas*, 505 U.S. at 1018.

Thus, in *Nollan*, there was no question that the proposed property use (significantly expanding an existing beachfront home) would contribute to the evils the Coastal Commission said it was acting to prevent—*e.g.*, obstruction of views of the beach and the creation of a psychological barrier to use of the beach. 483 U.S. at 835. But the burden the Commission imposed—requiring the Nollans to permit

access across their property to persons already on the beach—did not advance that purpose. *Id.* at 838. Thus, although the government's actions did not destroy the economic value of the Nollans' property, the Court found the government's regulatory action to constitute a taking.

Similarly, in *Dolan*, Ms. Dolan's proposed expansion of her retail store and parking lot would have been the source of increased traffic and stormwater run-off. A connection therefore existed between the proposed property use and the city's demand that Ms. Dolan dedicate a portion of her property to a greenway and bicycle path. 512 U.S. at 387. The Court nonetheless found a taking because the regulatory burdens were not shown to advance the city's purposes.[8] Requiring a public greenway did not advance the city's flood control purposes because a private greenway (*i.e.*, a requirement that Ms. Dolan leave the area undeveloped but without obligating her to grant public access) would accomplish the same result. *Id.* at 393-95. Similarly, the city had not shown that the bicycle path requirement was reasonably related to any increased traffic because it had not made an effort to quantify in any respect the degree to which the bicycle path would reduce the traffic impact. *Id.* at 395-96.

The State argues that the dispositive factor in *Nollan* and *Dolan* was that the government was seeking to extract rights of physical access to the plaintiffs' property. Pet. Br. 45. But the Court's analysis was not so limited. The relevant point was that the burden being demanded was one the government could not have directly imposed without paying compensation and its legitimacy therefore depended on some other justification. That is true whether the government is demanding an easement or imposing a regulatory restriction

[8] As in *Nollan*, there was no issue that the regulatory demand would deprive Ms. Dolan of the economic value of her property. *Dolan*, 512 U.S. at 385 n.6.

that could not be independently imposed. The outcome of *Nollan* would not have been different had the Coastal Commission conditioned the permit on the Nollans agreeing not to sell the property or not to occupy it for specified hours each day.[9] Nor would *Dolan* have been differently decided had the city required Ms. Dolan to dedicate as private open space land on the other side of the city if that would not address the runoff and traffic problems at issue. Under this Court's precedents, such regulatory burdens unconnected to a legitimate and related purpose cannot be imposed without compensation, whether they are imposed absolutely or conditionally.

C. The Due Process Clause Does Not Dictate the Standard for Evaluating Rights Under the Just Compensation Clause

1. The Governing Constitutional Standard Depends on the Nature of the Constitutional Prohibition at Issue

This Court's requirement that a land-use regulation substantially advance a state interest cannot be dismissed, as the State contends, Pet. Br. 23, as a "mistaken transposition of substantive due process doctrine into takings law." The State's apparent assumption is that any inquiry into the degree to which a regulation serves legitimate purposes is necessarily a due process challenge. The United States echoes this assertion, and suggests that all "economic legislation" enjoys broad immunity from meaningful review under the Constitution. U.S. Br. 13 (referring to "[t]he

[9] That *Nollan*'s analysis is not limited to exactions, but reflects a broader application of the substantially advances test, is demonstrated by the Court's recognition that even an outright denial of the requested permit would not be proper without compensation unless the Nollans' new home "would substantially impede" the Coastal Commission's legitimate interests. 483 U.S. at 835-36.

preeminence of legislative authority in the sphere of economic policy").

This is precisely the assertion this Court rejected in *Dolan*, when it held that "simply denominating a governmental measure as a 'business regulation' does not immunize it from constitutional challenge on the ground that it violates a provision of the Bill of Rights." 512 U.S. at 392. As the Court observed, there is "no reason why the Takings Clause of the Fifth Amendment, as much a part of the Bill of Rights as the First Amendment or Fourth Amendment, should be relegated to the status of a poor relation in these comparable circumstances." *Id.*[10]

Numerous cases confirm that economic legislation enjoys no special immunity from review when protection of a right specifically delineated and protected in the Constitution is at issue. Under the First Amendment, commercial speech holds a "subordinate position" and "does not stand on a par . . . with forms of speech more traditionally within the concern of the First Amendment" because commercial speech concerns purely economic matters. *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447, 455-56 (1978). Even so, commercial speech is not stripped of all constitutional protection save that of substantive due process. To satisfy the Free Speech Clause, economic regulation of commercial speech must directly advance a substantial state interest and

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[10] *See also Lynch v. Household Fin. Corp.*, 405 U.S. 538 (1972):

> [T]he dichotomy between personal liberties and property rights is a false one. Property does not have rights. People have rights. The right to enjoy property without unlawful deprivation, no less than the right to speak or the right to travel, is in truth, a 'personal' right.

Id. at 552; *see VanHorne's Lessee v. Dorrance*, 2 U.S. (2 Dall.) 304, 310 (1795) ("[T]he right of acquiring and possessing property, and having it protected, is one of the natural, inherent, and unalienable rights of man.").

be no more extensive than necessary to serve that interest. *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 557, 565 (1980). In determining whether economic legislation advances the state's interest, the state "must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree." *Edenfield v. Fane*, 507 U.S. 761, 771 (1993); *accord Cent. Hudson*, 447 U.S. at 564 (the state must provide more than "ineffective or remote support for the [state's] purpose").

Likewise, economic legislation that burdens interstate commerce is reviewed directly under the Commerce Clause, and under a standard tailored to the interests protected by that clause. Legislation that discriminates against interstate commerce is virtually *per se* unlawful. *Or. Waste Sys., Inc. v. Dep't of Envtl. Quality of Or.*, 511 U.S. 93, 99 (1994). Non-discriminatory regulation of commerce is upheld only if the economic legislation advances the state's interest such that the local benefits outweigh the burdens on commerce. *S. Pac. Co. v. Arizona*, 325 U.S. 761, 775-76 (1945). To satisfy that standard, a state must put forth "persuasive evidence" that the economic regulation furthers the state's interest. *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 671 (1981). A state may not avoid compliance with the Commerce Clause simply by providing a rational basis for economic legislation because to allow a state to do so "would mean that the Commerce Clause of itself imposes no limitations on state action other than those laid down by the Due Process Clause." *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 (1951); *see also Barnard v. Thorstenn*, 489 U.S. 546, 551, 552 (1989) (applying intermediate scrutiny to invalidate under the Privileges and Immunities Clause a state rule limiting bar admission to residents; requiring that the rule "bear[] a substantial relationship to the State's objectives").

As these cases demonstrate, the Due Process Clause is not the only check on governmental action in the economic sphere. Nor does it set the standard of judicial review for the

entire class of economic legislation. The governing standard is instead determined by the constitutional rights at issue: "[I]t is the character of the right, not of the limitation, which determines what standard governs [a constitutional claim]." *Thomas v. Collins*, 323 U.S. 516, 530 (1945). "[T]he standard of review is determined by the nature of the right assertedly threatened or violated rather than by the power being exercised or the specific limitation imposed." *Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 68 (1981) (reviewing economic legislation). The Constitution protects *rights*, not legislation.

Indeed, the Court has held that, "if a constitutional claim is covered by a specific constitutional provision, . . . the claim must be analyzed under the standard appropriate to that specific provision, not under the rubric of substantive due process." *United States v. Lanier*, 520 U.S. 259, 272 n.7 (1997); *see also Graham v. Connor*, 490 U.S. 386, 395 (1989) ("Because the Fourth Amendment provides an explicit textual source of constitutional protection against this sort of physically intrusive governmental conduct, that Amendment, not the more generalized notion of 'substantive due process,' must be the guide for analyzing these claims.").

2. *The Just Compensation Clause Is a Specific Constitutional Prohibition That Serves Purposes Distinct from Those of the Due Process Clause*

The Just Compensation Clause is such an explicit source of constitutional protection. It does not duplicate the requirement of the Due Process Clause that "due process of law" be provided before someone is deprived of "life, liberty or property."[11] Nor does it protect a generalized interest

[11] *Cf. Eastern Enters. v. Apfel*, 524 U.S. 498, 557 (1998) (Breyer, J., dissenting) ("Nor does application of the Due Process Clause automatically trigger the Takings Clause, just because the word 'property' appears in both. That word appears in the midst of different phrases with somewhat different objectives, thereby permitting differences in the way the term is interpreted.").

against arbitrary, unfair, or irrational governmental behavior. Instead, as discussed above (at 17-23), by permitting the government to act conditioned on paying just compensation, it serves the distinct purpose of ensuring that individual property owners are not made to bear alone "public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong*, 364 U.S. at 49.

Because the Just Compensation Clause is an express constitutional protection of a specific interest, the State's concern that enforcing the clause's basic purposes will herald a return of *Lochner*-era substantive due process review is unfounded. The vice of the *Lochner* period was use of the "vague contours of the Due Process Clause" to strike down state laws not "restrained by some express prohibition in the Constitution of United States." *Tyson & Bro.-United Theatre Ticket Offices, Inc. v. Banton*, 273 U.S. 418, 446 (1927) (Holmes, J., dissenting); *see also Ferguson v. Skrupa*, 372 U.S. 726, 730-31 (1963) ("It is now settled that States have power to legislate against what are found to be injurious practices in their internal commercial and business affairs, *so long as their laws do not run afoul of some specific federal constitutional prohibition, or of some valid federal law*." (emphasis added) (internal quotation marks omitted)). Untethered to any concrete basis in specific constitutional text, the courts invalidated laws based on their view of the law as "unwise, improvident, or out of harmony with a particular school of thought." *Williamson v. Lee Optical*, 348 U.S. 483, 488 (1955).

Neither this Court's focus on the nature of the government interest in regulatory takings cases, nor its specific

requirement that the regulation at issue substantially advance a legitimate state interest, licenses that kind of unconstrained judicial review. Unlike the *Lochner*-era due process cases, this Court's precedents applying the substantially advances requirement of the Just Compensation Clause do not sanction judicial second-guessing of the legitimacy of legislative ends.[12] The validity of the ends to be achieved is evaluated under the "public use" requirement, which this Court has held is governed by a highly deferential standard. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 241 (1984). The substantially advances requirement imposes no higher standard for evaluating the legislative purpose. *See Agins*, 447 U.S. at 261 (recognizing that the purpose of the zoning law to protect against the "ill effects of urbanization" has "long been recognized as legitimate"); *Nollan*, 483 U.S. at 835-36 (accepting as legitimate the government's interest in preserving views of the beach).

Nor does the substantially advances requirement evaluate the general wisdom or utility of legislation. The focus is instead on whether the law has unfairly singled out individual property owners for burdens that the public as a whole should bear. By asking whether the law substantially advances the governmental purpose, the courts evaluate whether the burden is properly placed on property that is the source of the problem at issue and whether the burden addresses that problem. *See supra*, pp. 17-23.[13]

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[12] *Cf. Coppage v. Kansas*, 236 U.S. 1 (1915) (finding illegitimate a legislative purpose to protect employees' ability to associate with a union).

[13] *See also* Douglas W. Kmiec, *The Original Understanding of the Takings Clause Is Neither Weak nor Obtuse*, 88 Colum. L. Rev. 1630, 1651 (1988) ("the nexus requirement to be applied in these cases measures not just the closeness of the fit between regulatory means and ends but also whether the burden of the regulation is properly placed on this landowner").

The Just Compensation Clause also differs from the Due Process Clause in that it is limited to "private property." Regardless of how the Court ultimately resolves the debate over precisely how to define "private property" for purposes of the Just Compensation Clause, *see infra*, pp. 37-38 (discussing *Eastern Enterprises*), that clause has a much narrower reach than the more broadly phrased Due Process Clause, which applies to deprivations of "life, liberty, or property." Thus, applying the substantially advances test under the Just Compensation Clause in cases such as this involving long-recognized, discrete interests in specific property does not imply its application to the broad range of general business regulation unrelated to specific property interests that was subject to intrusive *Lochner*-era review. *Cf. Jay Burns Baking Co. v. Bryan*, 264 U.S. 504, 513 (1924) (striking down regulation of size of bread loaves on the ground that government may not "arbitrarily interfere with private business"); *Lochner v. New York*, 198 U.S. 45, 60 (1905) (invalidating law limiting employee work hours on the ground that it interfered with "liberty of person and freedom of contract").

Nor does the substantially advances test impermissibly intrude on democratic values. To the contrary, it applies in those circumstances in which this Court has long recognized that judicial intervention is proper—where an express provision of the Bill of Rights protects individuals from being singled out by the majority for disparate burdens. *See W. Va. Bd. of Educ. v. Barnette*, 319 U.S. 624, 638 (1943) ("The very purpose of a Bill of Rights was to withdraw certain subjects from the vicissitudes of political controversy, to place them beyond the reach of majorities and officials and to establish them as legal principles to be applied by the courts."). This case illustrates the point. Act 257 burdens a discrete group of six property owners, all but one of which is based outside of Hawaii—and the one Hawaii-based owner is essentially unaffected because it sells almost exclusively through company-owned stations. *See*

supra, p. 2 n.3. While it may be politically attractive to force these companies to subsidize the operations of local lessee dealers, the very nature of the disproportionate burden the statute imposes tends to insulate it from normal democratic processes. *See Pennell*, 485 U.S. at 22 (Scalia, J., concurring in part and dissenting in part).

Finally, and perhaps most importantly, the substantially advances test differs from substantive due process analysis in that it does not bar the government from acting. As the State itself argues at length, except where the public use requirement is not met, the Just Compensation Clause permits the government to act so long as its pays compensation for property rights taken by its action. Pet. Br. 18 (citing *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 314 (1987)); *see also Eastern Enters.*, 524 U.S. at 545 (Kennedy, J., concurring in judgment) ("The Clause operates as a conditional limitation, permitting the government to do what it wants so long as it pays the charge."). Substantive due process analysis leaves no such option to the government but results instead in the invalidation of challenged governmental action outright.[14]

Significantly, the State ultimately disclaims any argument that the specific protections afforded by the substantially advances test are irrelevant to the Just Compensation Clause. Pet. Br. 36. Instead, the State asserts, those protections

[14] The State and its amici argue that a state should be free, "if its citizens chose, [to] serve as a laboratory; and try novel social and economic experiments." *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting); *see* Pet. Br. 40. But it is one thing for a state to engage in such experimentation when "its citizens chose" where the citizenry will bear the burden of that experimentation. It is far different when the burden of the experiment is unfairly concentrated on discrete property rights of only certain individuals. In that circumstance, the Just Compensation Clause permits the experiment, conditioned on the payment of compensation to properly allocate the burden to the public.

should be provided under the Due Process Clause, without the "confusing intermediation of the Just Compensation Clause." *Id.* at 35-36. As the foregoing paragraphs demonstrate, however, accepting this position would result in the very "mistaken transposition" of constitutional principles the State says it is seeking to avoid. It would cheapen Just Compensation Clause values by applying a standard of review not tailored to the specific interests protected by that clause. Protecting the rights guaranteed by the Just Compensation Clause, while at the same time not improperly expanding the reach of the Due Process Clause or imposing on government the absolute limits that result from due process condemnation, calls for review of regulatory takings under the standards of the Just Compensation Clause itself.[15]

3. The Substantially Advances Test is Consistent with and Supported by the Conditional Nature of the Just Compensation Clause

The State argues that the substantially advances test is inconsistent with the Just Compensation Clause because it supposedly asks whether the "government action can proceed at all." Pet. Br. at 19. This argument is meritless.

As discussed above (at 30), determining under the Just Compensation Clause that a law fails to substantially advance a legitimate state interest does not bar the government from acting. It means only that the law effects a taking for which compensation must be paid—just as the "permanent physical occupation," *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 (1982), and

[15] The fact that *Agins* cited to *Nectow v. Cambridge*, 227 U.S. 183 (1928), does not turn the substantially advances inquiry into a due process test. For the reasons discussed above, and as this Court's decisions both before and after *Agins* make clear, the substantially advances test is an inquiry under the Just Compensation Clause that serves the distinct purposes of that clause.

"economically beneficial uses," *Lucas*, 505 U.S. at 1019, tests identify takings for which compensation is owed. Thus, the Court recognized in *City of Monterey* that government action can proceed with compensation even when, as in that case, the challenged property regulation fails the substantially advances test. *See* 526 U.S. at 710 ("Had the city paid for the property or had an adequate postdeprivation remedy been available, Del Monte Dunes would have suffered no constitutional injury from the taking alone."). Indeed, *City of Monterey* decided that the Seventh Amendment provides a right to a jury trial on the substantially advances question in a Section 1983 action *for compensatory relief*. *Id.* at 708-11. If it were true that "compensation is a non sequitur" when property regulation fails the substantially advances test, U.S. Br. 23, the issue resolved in *City of Monterey* would be meaningless.

Similarly erroneous is the State's argument that the substantially advances test is inconsistent with the Fifth Amendment's "public use" requirement. Pet. Br. 19-21. The gist of the State's argument appears to be that any law that fails the substantially advances test necessarily also fails the public use standard. The result, according to the State, is a logical conundrum—the same circumstance that dictates that a taking has occurred and compensation is owed (failure to substantially advance) also dictates that the government is precluded from taking the property at all even with compensation (lack of a public use).

But the conundrum is of the State's own making. The public use requirement and the substantially advances requirement are not the same. Because the absence of a public use precludes the government from acting at all, this Court's precedents have, as noted above, evaluated the existence of a public use under a highly deferential standard. *Midkiff*, 467 U.S. at 240-42. At the same time, however, the Court has recognized that a law that satisfies this highly deferential standard may yet be so unfair to individual property owners that it fails the substantially advances test.

Thus, in *Nollan*, *Dolan*, and *City of Monterey* there was no question the challenged action satisfied the public use requirement. *Nollan*, 483 U.S. at 835 (accepting legitimacy of state interest in preserving visual access to the ocean); *Dolan*, 512 U.S. at 387 (preventing flooding and reducing traffic congestion "qualify as the type of legitimate public purposes we have upheld"); *City of Monterey*, 526 U.S. at 706 ("the jury was instructed, in unmistakable terms, that the various purposes asserted by the city were legitimate public interests"). Yet, in each case, the government action was found to constitute a taking for which compensation was required because the regulation failed the substantially advances requirement.

These differing standards for evaluating when the public use requirement is satisfied and when the substantially advances test is met are consistent with basic Just Compensation Clause principles. The deferential standard that governs the public use requirement is predicated on the assumption that the government will be paying for the taking. *See Midkiff*, 467 U.S. at 245 ("we assume for purposes of these appeals that the weighty demand of just compensation has been met"). The question it asks is whether the government is prohibited from acting even in that circumstance. Deferring to the government in that situation finds support in the fact that the result—permitting government action conditioned on payment—does not defeat the core purpose of the Just Compensation Clause. And a contrary outcome would prevent the government from acting at all.

Different considerations apply, however, when the government seeks to proceed without paying compensation. In that circumstance, the core purpose of the Just Compensation Clause of protecting property owners from being deprived of their property rights without compensation is directly implicated and the balance of competing interests is altered. From the property owner's perspective, the governmental intrusion is greater, as the government is seeking not

only to deprive the owner of protected property interests but to do so without any payment. At the same time, the government's interest in its proposed action is diminished because its right to act at all is not being challenged. Instead, it is allowed to proceed so long as it pays for the private property rights destroyed by its action.

Nor is the State aided by its assertion, Pet. Br. 21-23, that compensation rather than an injunction is the appropriate remedy in a takings case. Nothing in the substantially advances test dictates an injunctive remedy or other remedy different from those available in any other situation when an uncompensated taking is found. As the State acknowledges, this Court's decisions have recognized the propriety of declaratory or injunctive relief against uncompensated takings in a variety of circumstances. *See* Pet. Br. 22 n.9; *see also* U.S. Br. 22 n.11. Indeed, the principal decision on which the State relies as establishing the compensatory focus of the Just Compensation Clause itself approved relief in the form of "a judicial declaration that [an] ordinance[] has effected an unconstitutional taking of property." *First English*, 482 U.S. at 317. These decisions recognize that declaratory or injunctive relief does not prohibit the government from acting, but merely requires that the government pay for its action should it elect to continue.[16] But whether

[16] In fact, there is little practical difference between such a declaration and a court's "ordering the government to afford compensation for the permanent taking." *First English*, 482 U.S. at 335 (Stevens, J., dissenting). "The difference . . . is only in what will happen in the case of Legislative or Executive inertia," because the government can overcome the court's order either by paying just compensation or by repealing the property regulation, as the case may be. *Id.*; *see also id.* at 317 (majority op.) (government may avoid future payment obligation by electing to "acquiesce" in judicial declaration of unconstitutional taking). Moreover, a declaration or injunction is the *less* intrusive form of relief—and more consistent with the government's apparent intent—where, as here, there is no indication that the government intended to exercise its

such relief is an appropriate remedy in this or any other case has nothing to do with the validity of the substantially advances test. If injunctive relief is not proper in a given case, the proper response is to deny that remedy in favor of a compensatory remedy, not to jettison the substantive standards for determining the underlying liability question. Here, the State objected only to the substantive determination that Act 257 effects a taking absent compensation being paid. The State never contended that, assuming a substantive violation of the Just Compensation Clause is found, it was error for the district court to award declaratory or injunctive relief rather than compensation.

D. The Substantially Advances Test Is an Established Part of this Court's Regulatory Takings Jurisprudence

Labeling it "dictum" and this Court's "locution" in *Agins*, the State questions whether the substantially advances test is "actually part of current takings doctrine at all" and asserts that "nothing bars" the Court from now abandoning it. Pet. Br. 23, 25, 29. These contentions are without merit.

The State asserts that the Court's application of the test in *Agins* was dictum because the Court concluded that the test was met. But the fact that a test is satisfied does not mean that it is not the test. The State cites no authority holding that the Court's pronouncement of a governing constitutional standard is dictum whenever the standard is applied to uphold rather than invalidate the challenged action. This Court's decisions reject that assertion. *See Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 66-67 (1996) ("rationale upon which the Court based the results of its earlier decisions" is

taking power when it enacted the statute. *Id.* at 317 ("[T]he landowner has no right under the Just Compensation Clause to insist that a 'temporary' taking be deemed a permanent taking.").

not dicta); *id.* at 67 ("'As a general rule, the principle of *stare decisis* directs us to adhere not only to the holdings of our prior cases, but also to their explications of the governing rules of law.'") (quoting *County of Allegheny v. ACLU*, 492 U.S. 573, 668 (1989) (Kennedy, J., concurring and dissenting)). If the rule were as the State contends, countless decisions of this Court could be disregarded as dictum, including the modern substantive due process cases and the public use cases on which the State relies, each of which sustained the laws at issue. Indeed, under the State's standard, *Penn Central* itself would be dictum.

Nor has this Court treated *Agins* as dictum. Less than a year after *Agins* was decided, Justice Brennan described *Agins* as a "clear precedent[]" that a regulation effects a taking if it "does not substantially advance legitimate state interests." *San Diego Gas & Elec.*, 450 U.S. at 647 (Brennan, J., dissenting). In *Keystone*, the Court described *Agins* as a holding that "land use regulation can effect a taking if it does not substantially advance legitimate state interests." 480 U.S. at 485 (internal quotation marks omitted). The Court identified this standard as an "integral part[] of our takings analysis." *Id.* In *Nollan*, the Court stated, citing to *Agins*, that it has "long recognized that land-use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests.'" 483 U.S. at 834. And the Court applied the substantially advances test to invalidate governmental action in *Nollan* and *Dolan*. These cases are irreconcilable with any notion that *Agins*' articulation and application of the substantially advances test was anything less than a holding of the Court. At most, the fact that *Agins* and other cases have found the test satisfied simply means that it imposes a relatively minor burden that the government can easily meet, except where (as here) the government has singled out discrete property interests that are not the source of any condition the government seeks to address.

The State's "dictum" contention also ignores that *Agins* itself merely restated a requirement the Court had already

recognized in its prior cases. As discussed above, the test was first expressly articulated in *Penn Central*, 438 U.S. at 104. And as *Lucas* observed, 505 U.S. at 1023-24, its "progenitor" is found in the Court's "noxious use" cases, which predicated the government's ability to take property without compensation on a causal connection between the property's use and the social condition the state was acting to address. Repudiating the substantially advances requirement would thus be repudiating not merely *Agins* but basic principles that have guided this Court's regulatory takings jurisprudence for over eighty years.

Nor is there any merit to the State's assertion that "five Justices" rejected the substantially advances test in *Eastern Enterprises*. Neither the validity nor the application of the substantially advances test was at issue in that case. The plurality concluded that the law was invalid under the general *Penn Central* analysis, without any need to focus on the more particular substantially advances requirement. *Eastern Enters.*, 524 U.S. at 529-37. The plurality relied primarily on the severe and unanticipated retroactive nature of the liability, concerns that do not directly implicate the substantially advances requirement.

Justice Kennedy concurred in the judgment, concluding that the law's validity should be analyzed under the Due Process Clause rather than the Just Compensation Clause. Contrary to the State's assertion, Pet. Br. 30, however, Justice Kennedy's disagreement with the plurality was not over the validity of the substantially advances test (which the majority had not applied). Instead, he concluded that the Takings Clause was inapplicable because the Coal Act "does not operate upon or alter an identified property interest." 524 U.S. at 540. He reasoned that the Court's regulatory takings cases have involved "specific and identified properties or property rights." *Id.* at 541. By contrast, the Coal Act "simply imposes an obligation to perform an act, the payment of benefits. The statute is indifferent as to how

the regulated entity elects to comply or the property it uses to do so." *Id.* at 540.

The State relies on Justice Kennedy's observation that the "normative judgment[s]" required by the Court's regulatory takings doctrine are in "uneasy tension" with the understanding of the Just Compensation Clause as not prohibiting governmental action. *Id.* at 544-45. But this observation cannot be read as repudiating the substantially advances test. As Justice Kennedy observed, *id.*, the nature of the Just Compensation Clause itself inherently requires normative judgments about the "fairness and justice" of imposing burdens on discrete property owners. *Armstrong*, 364 U.S. at 49. Moreover, as discussed above (at 13-17), regulatory takings doctrine from the beginning has required inquiry into the character of the government's interest, including the relationship between the asserted interest and the burdens imposed on property. Justice Kennedy noted the "difficult and uncertain" nature of these inquiries not to suggest that the regulatory takings doctrine be abandoned, but to support his conclusion that the Court should adhere to the "one constant limitation" that the inquiry be restricted to cases in which "a specific property right or interest" is at stake. 524 U.S. at 541. Likewise, he did not suggest that due process analysis should replace scrutiny under the Just Compensation Clause. Instead, he concluded that the Court should "proceed *first* to general due process principles," and then proceed to takings analysis if the government's action passes muster under those principles. *Id.* at 546 (emphasis added).

Similarly, Justice Kennedy's observation that the plaintiff's challenge to the Coal Act "appears to turn on the legitimacy of Congress' judgment rather than on the availability of compensation," *id.* at 545, was a reflection of the peculiar nature of the generalized economic loss the plaintiff alleged in that case, rather than a universal statement about every case in which the substantially advances test is at issue. Where, as in this case, a "specific property right or interest" is at stake, a claim of an

uncompensated regulatory taking falls squarely within this Court's Just Compensation Clause precedents.[17]

The State's assertion that *Eastern Enterprises* overruled *Agins* and abandoned the substantially advances test is also contradicted by this Court's subsequent decisions describing the test as consistent with the Court's regulatory takings precedents, *City of Monterey*, 526 U.S. at 704, and as a theory under which a regulatory taking may be established, *Tahoe-Sierra*, 535 U.S. at 334. While the State observes that the propriety of the test was not directly at issue in those cases, it would be strange indeed for the Court to have approvingly referred to the test if it had already rejected it (or fatally undermined it) only shortly before.

II. THE JUST COMPENSATION CLAUSE REQUIRES MORE THAN MERE RATIONALITY

A. The State's Argument Is Inconsistent with This Court's Precedents and the Purposes of the Just Compensation Clause

The State's argument that the Just Compensation Clause imposes no more than rational basis review is largely a reprise of its argument that the Due Process Clause provides the governing standard here—and it is wrong for the reasons already discussed. Contrary to the State's argument that deferential review is required whenever economic legislation is involved, "regardless of the specific constitutional provision invoked," Pet. Br. 37, 39, this Court has repeatedly

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[17] Justice Kennedy also found support for his conclusion that the Due Process Clause, rather the Just Compensation Clause, applied in the fact that the principal focus of the plaintiff's complaint—the retroactive nature of the economic liability imposed by the Coal Act—fits within the "well-settled due process principles respecting retroactive laws." *Id.* at 547. By contrast, a claim that a regulation unfairly imposes burdens on specific property interests unrelated to any problem caused by the property is most directly a Just Compensation Clause issue.

applied higher levels of scrutiny to economic legislation when that legislation is alleged to violate specific constitutional guarantees, such as the Just Compensation Clause. *See supra*, pp. 24-26. The State's assertion that "[n]othing in the Just Compensation Clause," Pet. Br. 40, supports more searching scrutiny ignores the distinct purposes that the Just Compensation Clause serves, as well as the lesser, conditional burden it places on governmental behavior as compared to other constitutional provisions. *See supra*, pp. 26-31.

The State's argument is also inconsistent with this Court's pronouncements on this very subject. In *Nollan*, the Court emphasized that the standard for evaluating a substantially advances claim under the Just Compensation Clause is not the same as that applied to due process and equal protection claims: "We have required that the regulation substantially advance the legitimate state interest sought to be achieved, not that the State *could rationally have decided* that the measure adopted might achieve the State's objective." *Nollan*, 483 U.S. at 834 n.3 (quotation marks and citation omitted). The Court thus rejected the dissenting opinion's reliance on the very same due process and equal protection precedents that the State now cites as establishing the proper standard of review. As the Court recognized,

> there is no reason to believe (and the language of our cases gives some reason to disbelieve) that so long as the regulation of property is at issue the standards for takings challenges, due process challenges, and equal protection challenges are identical; any more than there is any reason to believe that so long as the regulation of speech is at issue the standards for due process challenges, equal protection challenges and First Amendment challenges are identical.

Id. The State tries to dismiss this rejection of its position as limited to the "exactions" context. Pet. Br. 48 n.18. But the Court was describing the operation of the substantially

advances test in general, not its particular application in the exactions context. It thus relied on *Agins* and *Penn Central*, neither of which were exactions cases.[18]

Nor is there any merit to the State's attempt to recast *Agins* and other more recent takings cases as requiring only mere rationality. Pet Br. 42-48. The Court in *Agins* affirmatively concluded that the zoning ordinances at issue there would substantially advance the city's goals, not merely that the city might have rationally so concluded. 461 U.S. at 261-62.

The State likewise mischaracterizes the debate between the majority and dissent in *Keystone*. Pet. Br. 45-47. There was no question in that case that the property use at issue was causally connected to the subsidence problem the state was seeking to address. Nor was there any question that the statute would protect against subsidence. The majority was therefore not addressing those issues—which are the focus of the substantially advances test—but instead was concerned with whether the "true nature" of the statute was to protect against public harms or merely to protect the private interests of certain surface landowners. The majority concluded that the various provisions of the statute showed that it was intended to protect against public harms, in contrast to the Coal Act in *Mahon*, which Justice Holmes described as a "'private benefit' statute." *Keystone*, 480 U.S. at 485-88; *see Mahon*, 260 U.S. at 413-14.

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[18] The Court rejected any contrary assumption made in *Goldblatt v. Hempstead*, 369 U.S. 590 (1962), not on the ground that *Goldblatt* was not an exactions case, but on the ground that any such assumption in *Goldblatt* was inconsistent with "our later cases." *Nollan*, 483 U.S. at 834 n.3. By referring to "our later cases," the Court made clear that it was not announcing a new standard in *Nollan* limited to exactions cases, but was referring to a standard already established in prior, non-exactions cases.

It was in that context of evaluating the nature of the legislature's purposes that the *Keystone* dissenting opinion observed that the Court's "inquiry into *legislative purpose* is not intended as a license to judge the effectiveness of legislation," 480 U.S. at 511 n.3 (Rehnquist, C.J., dissenting) (emphasis added)—a point with which the majority said it agreed, *id.* at 487 n.16. But neither the majority nor the dissent said anything about the level of scrutiny to be applied when the issue is not the nature of the legislative purpose (*i.e.*, the extent to which it was intended to protect against private as opposed to public harms), but is instead whether the statute unfairly singles out property owners to remedy problems not attributable to the burdened property.[19] Nor are the issues the same. Deferring to the legislature in the context of identifying the purposes the legislature intended the statute to serve is a far cry from holding that the legislature's view is controlling on whether the statute violates the core purpose of the Just Compensation Clause of preventing the government from singling out individual property owners for burdens that should be borne by the public as a whole.

The State also errs in suggesting that *City of Monterey* supports deferential review. Pet. Br. 46-47. The State relies on *City of Monterey*'s holding that the "rough-proportionality" requirement applied in *Dolan* is limited to exactions cases. That holding, however, was simply a

[19] That the issue being debated was the general nature of the legislative purpose is evidenced by Chief Justice Rehnquist's reliance on *Midkiff*, which involved the "public use" requirement of the Fifth Amendment, not the substantially advances standard. *See* 480 U.S. at 511 n.3. Significantly, after noting the Court's reticence to question the government's purposes, Chief Justice Rehnquist warned that the fact that the legislation may "efficiently achieve[] its desired objectives" does not establish that "the compensation required by the Fifth Amendment is unavailable." *Id.*

recognition that that specific requirement "is not readily applicable" when the claim is that development was denied outright rather than conditioned on "excessive exactions." 526 U.S. at 703. The Court did not suggest that the more general requirements of the substantially advances test are limited to the exactions context—including the basic requirement that a nexus exist between the property burdened and the problem the government seeks to address. Nor did it hold that courts are limited to mere rationality review when applying that test. The Court's recognition that the jury instructions given in that case setting out the substantially advances test were consistent with the Court's regulatory takings precedents belies any such conclusion. *Id.* at 704; *see also id.* at 707 (rejecting as "contrary to settled regulatory takings principles" the city's argument that its land use decisions are "immune from judicial scrutiny").

Schad v. Borough of Mt. Ephraim, 452 U.S. 61 (1981), also does not help the State. No claim was made in that case under the Just Compensation Clause—let alone any claim that the ordinance failed the substantially advances test under that clause. Instead, the contention was that the ordinance violated the appellants' rights of expression under the First Amendment. The Court thus had no occasion to address the standard that would have applied to a Just Compensation Clause claim, had one been made.

The State places particular reliance on *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), asserting that applying meaningful scrutiny under the Just Compensation Clause would mean that the result in that case would have been different if only the oil companies there had "relabeled" their due process claim as a takings claim. Pet. Br. 42. The statute in that case, however, was significantly different from Act 257. It did not take a discrete property right (such as the right to collect rents from real property) or attach to any real property a restriction on that property's use. It was instead a general restriction on the retail distribution avenues oil companies could use. Applying the Just Compensation

Clause here says little or nothing about its application to such a regulatory scheme governing the oil companies' conduct. Moreover, assuming that the substantially advances test would apply to the Maryland law, the question would be whether the prohibited station operations were the source of the problem the legislature sought to address and whether the burden was sufficiently related to the law's purposes. Unlike the statute here, the Maryland statute was enacted in response to evidence that the oil companies there were allocating oil supplies in times of shortage to their own stations to the exclusion of other distribution avenues. 437 U.S. at 121. The outcome of the inquiry into the validity of that statute would not necessarily be the same as it would be for the different statute here.

The State suggests that rational basis review is proper because all property owners hold their property with the understanding that the government may regulate its use to serve the public good. Pet. Br. 40. But this only proves the point. Property owners do not expect that their property will be taken without compensation for the stated purpose of addressing problems that their property did not create or that will not be ameliorated by the policies at issue. The purpose of the Just Compensation Clause is precisely to prevent the government from unfairly burdening protected property rights in that fashion. The government should not be permitted to evade this guarantee by application of a toothless standard of review that provides no meaningful check on the very evils the Just Compensation Clause was adopted to prevent.

B. Meaningful Scrutiny Under the Just Compensation Clause Does Not Require *De Novo* Review

At bottom, the State's argument that only rational basis scrutiny is appropriate rests on the premise that the only alternative is "*de novo*" review in which the courts accord "no weight whatsoever" to legislative economic policy judgments. Pet. Br. 38, 42. That premise is unfounded.

Meaningful scrutiny does not require *de novo* review. Nor is *de novo* review necessary to find that the statute here effects an uncompensated taking in violation of the Fifth Amendment.

As the United States recognizes, even where intermediate scrutiny applies, legislative judgments may be entitled to deference. U.S. Br. at 13 n.4. Thus, in *Turner Broadcasting System v. FCC*, 512 U.S. 622 (1994), the Court held that Congress' "predictive judgments" are entitled to "substantial deference." *Id.* at 665. At the same time, however, the Court made clear that deference does not mean that legislative judgments are "insulated from meaningful judicial review." *Id.* at 666. The government "must do more than simply posit the existence of the disease sought to be cured." *Id.* at 664 (internal quotation marks omitted). It is required instead to "demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Id.* The courts' obligation is to exercise their "independent judgment" to assure that "Congress has drawn reasonable inferences based on substantial evidence." *Id.* at 666; *see also Edenfield v. Fane*, 507 U.S. 761, 770 (1993) (restriction on commercial speech may not be sustained on the basis of "mere speculation or conjecture").

Ultimately, the Court upheld the statute challenged in *Turner*. But it was only after first remanding the case for a "more substantial elaboration" of the actual evidence supporting the statute, 512 U.S. at 667, and only after concluding that Congress' detailed findings, reached after three years of preenactment hearings and set forth in the act itself, were in fact supported by the extensive body of evidence Congress had amassed, *Turner Broad. Sys. v. FCC*, 520 U.S. 180, 197-210 (1997).

Here, the opposite is true. Act 257 is not accompanied by any legislative findings that rents charged to lessee dealers are the cause of high gasoline prices in Hawaii, that

controlling rent will lower gasoline prices, or that the rent levels that are prohibited by the State pose any threat to the ability of lessee dealers to remain in business, either individually or as a whole. Nor did the State make any showing that the Legislature had investigated these issues or gathered any evidence that might demonstrate that rent charged to lessee dealers was a problem or that controlling it might be a solution. Instead, the State relied solely on the testimony of its litigation expert as the basis for the validity and effectiveness of the burden its statute imposed. The State made no attempt to demonstrate that this expert's trial opinions correlated in any way with anything the Legislature ever considered or concluded. To the contrary, it was clear that the expert was engaged solely in an after-the-fact effort to devise some theory by which the statute might be thought to accomplish some legitimate goal.[20] The State cites no authority suggesting that this kind of testimony constitutes a "legislative judgment" on an issue of "public policy" to which a district court exercising the scrutiny mandated in Just Compensation Clause cases must defer.

Even if the litigation testimony of an expert could substitute for the legislature's own judgment, the State is incorrect in asserting that the validity of Act 257 under the substantially advances test involves resolving conflicting evidence or deciding which party's evidence is more persuasive. As discussed above (at 3, 6), the State's expert did not present any evidence that Chevron's rents to lessee dealers have been the cause of any problem Act 257 seeks to address. To the contrary, he affirmatively disavowed any

[20] *See* JA 127-35 (describing how the State's expert and a deputy attorney general worked after the statute was enacted to try to devise a way "to show that the rent control would combat the problems with the high concentration that the legislature was talking about;" "I was looking for a connection between the rent control aspects of the bill and wholesale—high wholesale prices.").

such contention and the State makes no claim otherwise. Nor could it, given that the rents Chevron has charged have not covered Chevron's expenses and that lessee dealers far outnumber company-operated stations and are the predominant avenue through which Chevron and other refiners sell their gasoline. Thus, no second-guessing of any legislative economic policy judgment or picking between competing expert views is required to conclude that the State has taken property rights here that have not contributed to any problem the State seeks to correct or interfered with any purpose the State seeks to advance.

Even on the question whether Act 257 will achieve any legitimate purpose (putting aside that it targets property rights that have not caused any problem), no resolution of conflicting evidence is necessary. The State does not contend that taking Chevron's rents and transferring them to dealers will cause those dealers to lower their gasoline prices. To the contrary, both it and its expert conceded that that will not happen. *Supra*, p. 4. Nor is there any conflict in the evidence that, to the extent the oil companies do not raise their wholesale gasoline prices in response to the lost rental revenue (which the State's expert conceded would cause retail prices to increase, contrary to the State's goals), the effect of the statute will be to decrease the oil companies' incentive to invest in lessee-dealer stations.[21]

[21] The State emphasizes the district court's statement that it found "more persuasive" Chevron's expert's conclusion that the oil companies would respond to lost rent by raising their wholesale gasoline prices. Pet. Br. 38 (citing Pet. App. 43). But neither the district court's ultimate ruling, nor the constitutionality of Act 257, turns on that conclusion. To the extent that oil companies are not able to raise their wholesale prices, it was undisputed (and the district court found) that the effect will be to put money in the dealers' pockets and create a disincentive to investment in lessee-dealer stations—contrary to the State's goals. And none of this

That leaves the State's contention that the law at least serves the purpose of preventing oil companies from in the future engaging in rent increases that might drive lessee dealers out of business. But on this issue as well, no legislative economic policy judgment or conflicts in the evidence are involved. First, the Hawaii Legislature made no finding that Chevron or any other company has sought or likely will seek to drive lessee dealers out of business in Hawaii by charging excessive rents. Nor did the State's expert make any such assertion—let alone identify any evidence that would support such an assertion. To the contrary, he admitted he was unaware of any such evidence. *Supra*, pp. 3, 6. Moreover, neither the State nor its expert has offered any explanation for why it would make any sense for an oil company to run lessee dealers out of business for the purpose of replacing them with company-operated stations when Hawaii law separately prohibits oil companies from converting lessee-dealer stations to company-operated stations or from opening any company-operated stations in the proximity of a lessee-dealer station. Pet. Br. App. 2-3.[22]

changes the basic problem that the statute burdens property rights that are not claimed to have caused any problem.

[22] The State suggests that a rent cap is necessary to prevent oil companies from circumventing the conversion prohibition by accomplishing conversion "indirectly." Pet. Br. 3. But the conversion prohibition contains no exception for instances in which the lessee dealer goes out of business. In that circumstance, the company is allowed to operate the station only for up to 24 months until a replacement dealer can be found. Pet. Br. App. 2-3. If no replacement dealer is found, the company remains barred from taking over operation of the station or from opening a new company-operated station in the immediate vicinity.

Act 257 does not prevent oil companies from converting lessee-dealer stations to open-dealer stations (*i.e.*, stations both owned and operated by the dealer). But because such dealers are independent of the oil company, the State makes no claim that such conversions threaten any purpose behind Act 257.

Given the specific protection for property rights afforded by the Just Compensation Clause, the State was required at least to identify some credible evidence suggesting the likelihood of the posited harm before taking property to avert that harm. *See Turner*, 512 U.S. at 664, 666 (merely "posit[ing] the existence of the disease sought to be cured" is insufficient; it must be shown "that the recited harms are real, not merely conjectural" and the government's "inferences [are] based on substantial evidence").[23]

But even had the Hawaii Legislature made a considered judgment that oil companies were likely to raise their rents "to the point that existing dealers would be forced out of business," Pet. Br. 3, it made no judgment that the rents prohibited by Act 257—*i.e.*, the rents that the State stipulated that Chevron would charge absent the statute—would have that effect. The result of Act 257 is therefore to deprive Chevron of a property interest that is not even claimed to have any relation to any purpose advanced by the State. The only effect of prohibiting Chevron from charging the rents it would have charged absent Act 257 is to appropriate and transfer to lessee dealers a valuable property interest belonging to Chevron. No principle of deference is violated by giving effect to the express protections of the Just

[23] The State wrongly claims, Pet. Br. 3 n.1, that Congress passed the Petroleum Marketing Practices Act, 15 U.S.C. § 2801 *et seq.* (the "PMPA"), out of concern that oil companies would use rent increases to eliminate lessee dealers as independent competitors. In fact, neither the text nor the legislative history of the PMPA expresses any basis for that statute in concerns about competition. Rather, the PMPA is directed toward protecting dealers (not consumers) from perceived undue leverage that could be exerted by the oil companies, a goal that the State expressly disclaims for Act 257 at page 4 of its brief. The State cites S. Rep. No. 102-450 (1992) (Senate Comm. on Judiciary), to show that concerns about competition "led Congress to enact the" PMPA. But that Senate report was issued 14 years *after* the PMPA was enacted and accompanied a bill that was not passed in either house of Congress.

Compensation Clause against such governmental appropriation of private property interests.[24]

CONCLUSION

The judgment of the Ninth Circuit should be affirmed.

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[24] The State's petition is limited to the validity of the substantially advances test and the standard of review. Assuming that the test is valid and that it requires more than mere rationality, the State does not challenge the rulings of the courts below that Act 257 effects a taking. Nor would any such challenge have merit. For reasons discussed above, the rent control provisions of Act 257 impose the kind of unfair, disproportionate burden on discrete property rights that the Just Compensation Clause prohibits absent compensation.

(26)

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IN THE

Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, AND MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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As the State has explained, the lower courts erred in deciding, using a *de novo* standard of review, that Act 257 effected a "taking" because it "failed to substantially advance" the State's interest in protecting gasoline consumers. This analysis was wrong because (1) it assumed that an inquiry into the alleged illegitimacy of a government action can support a finding of a taking under the Just Compensation Clause, and (2) it further assumed that this inquiry (even if it were appropriate under that Clause) could be carried out without according deference to the policy judgments of Hawaii's legislators.

As to the first point, Chevron offers a pastiche of unconvincing arguments that attempt to make the "substantially advance" test appear less foreign to traditional takings principles than it actually is. Thus, Chevron contends that this test represents an application of the familiar "character" factor in taking analysis (even though the Court has never defined character in this fashion); that it is designed to prevent the government from unfairly singling out one or a few property owners to bear the costs of social programs (even though the substantially advance inquiry ignores whether *any* burden has been imposed); and that it is consistent with the compensatory purpose of the Just Compensation Clause (even though Chevron disclaimed any interest in compensation until it filed its brief in this Court, and the Ninth Circuit has ruled that this takings theory supports requests for injunctive relief). Chevron's *amici* present such a discordant array of theories in support of the result below that they simply highlight the basic point: there is no coherent justification for a "substantially advance" takings test, because this inquiry does not fit in takings law.[1]

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[1] Chevron's *amici* variously suggest, for example, that (1) this test is actually grounded in the Court's precedents interpreting the "public use" requirement (Richards family), (2) the test reflects a "fusing" of takings and due process doctrines (National Association of Homebuilders), or (3) the validity of the test is beside the point because in any event Act 257 effects a physical occupation resulting in a *per se* taking (Cato Institute).

On the second point, Chevron does not deny that the lower courts conducted a *de novo* factual inquiry, and it makes no attempt to defend the application of that remarkably intrusive standard of review. Chevron thus effectively abandons the Ninth Circuit's holding that the substantially advance test requires a factual determination, by a preponderance of the evidence, of the effectiveness of challenged legislation. That concession, by itself, provides a second ground for reversal. As a fall back position, Chevron argues that the lower courts properly found a taking because the Hawaii legislature failed to engage in a sufficiently thorough analysis of its policy options prior to enacting Act 257. There is no basis in takings jurisprudence for imposing this kind of retrospective procedural straitjacket on the legislative process. The argument is in any event based on a false premise, because the Hawaii legislature conducted an exhaustive investigation, spanning half a dozen years, before enacting Act 257.

This case, quite simply, is about Chevron's dissatisfaction with classic price control legislation enacted by the Hawaii legislature—where Chevron's arguments were heard, considered, and rejected. The Just Compensation Clause does not authorize the courts to overturn the legislature's reasonable accommodation of the various economic interests at stake in the retail gasoline market in the State of Hawaii.[2]

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[2] Chevron stipulated that it suffered no constitutionally significant economic injury as a result of Act 257. JA 40. But the company nonetheless attempts before this Court to exaggerate in various ways the economic effects of the legislation. As an initial matter, Chevron seeks to define the relevant unit of property as the rent it receives (or even more narrowly, the "right to collect market rents"). Chevron Br. i, 13. In fact, Chevron's gas station properties, either individually or collectively, represent the relevant unit of property for the purpose of takings analysis, as Chevron itself acknowledged in its briefing before the Ninth Circuit. *See* Brief of Appellee at 31-32 (Nov. 26, 2002) (describing property interest as company's "leasehold interests" in its stations). In any event, there was no evidence that Act 257 had any effect on current rents, and it reduced the rents that Chevron planned to charge if the law had not been enacted by only a small amount: a mere 4% of Chevron's projected rent stream from its lessee-dealer stations. JA 45-47. Chevron never even made a proffer of proof that Act 257 had reduced the value of its dealer stations or of its business enterprise in Hawaii as a whole. *See* Decl. of Keith Leffler, Docket No. 34 (July 30, 1998) (noting that in 1997 Chevron made $14.7 million in before-tax profits, a return of over 39% on the book value of its stations).

I. THE ALLEGED FAILURE OF ECONOMIC LEGISLATION TO "SUBSTANTIALLY ADVANCE" A LEGITIMATE STATE INTEREST DOES NOT SUPPORT A CLAIM OF A TAKING UNDER THE JUST COMPENSATION CLAUSE

A. The "Substantially Advance" Test Is A Misplaced Due Process Analysis

In its opening brief, the State explained that the "substantially advances" test reflects a transposition of due process thinking into takings law, where it fundamentally does not belong. This is confirmed by the essential identity of traditional substantive due process analysis with the substantially advance inquiry; the historical evidence that this test was borrowed from due process precedents; and the fact that the test has been read to support a request for injunctive relief, which is a due process, not a takings, remedy. Chevron's efforts to show otherwise are unavailing.

Chevron contends that heightened means-ends scrutiny of legislation affecting property interests is a proper takings test because the Just Compensation Clause evinces special solicitude for property interests above and beyond the "generalized" protection "against arbitrary, unfair or irrational governmental behavior" provided by the Due Process Clause. Chevron also argues that heightened review of state economic regulation under this standard does not "herald a return of *Lochner*-era substantive due process review" because the version of means-ends analysis employed in this case is not grounded in the "vague contours of the Due Process Clause," but is instead "tethered" by the "express" and "specific" Just Compensation Clause. *See* Chevron Br. at 27.

This argument effectively seeks to overturn decades of this Court's constitutional teachings. In Chevron's world, and that of its *amici*, any regulation affecting property interests beyond a trivial degree could be held unconstitutional unless it can be demonstrated to a court's satisfaction that the regulation is supported by prevailing economic theory and likely to work in practice. The clear effect—and, one suspects, the intent—of this position would be to bring much government economic regulation to a halt. As political philosophy, this stance is debatable; as constitutional law, it is not. As Justice Holmes observed in dissent almost exactly a century ago in *Lochner v. New York*, 198 U.S. 45, 75 (1905), the Fourteenth Amendment "does not enact Mr. Herbert Spencer's Social Statics" or any other particular theory of economics. And given that the Due Process Clause clearly does not support Chevron's approach to judicial review of economic regulation, it would be "surprising indeed" to discover, at this late stage of development of American constitutional law, that the Just Compensation Clause does. *Cf. Connolly v. PBGC*, 475 U.S. 211, 223 (1986).

In any event, Chevron's argument is not persuasive on its own terms. Because the "substantially advance" inquiry is indistinguishable from traditional substantive due process analysis, and was actually derived from precedents interpreting the Due Process Clause, the claim that heightened means-ends review can be justified based on the specific language of the Just Compensation Clause itself is both nonsensical and a historical. This test, in origin and in substance, is a due process test; the fact that the test has been relabeled as a taking test does not support the assertion that the test is actually tethered to the language of the Just Compensation Clause.

Chevron also argues that the Just Compensation Clause protects "property," whereas the Due Process Clause protects "life, liberty, and property," suggesting that the Due Process Clause has a broader scope than the Takings Clause. But this argument does not justify transplanting due process means-

ends analysis into takings law—much less transplanting it *and* intensifying it. And to the extent Chevron is suggesting that the dangers of *Lochner*-style judicial review are less serious so long as it is confined to the realm of property, this suggestion should be rejected as well. In the first place, it is difficult to see how any limitation of heightened review to laws affecting "property" is a limitation at all; virtually every form of governmental economic regulation affects some form of property (including real property, personal property, or intellectual property). Second, and more generally, the *Lochnerian* approach advocated by Chevron is a problematic intrusion on the principle of legislative primacy under our constitutional system regardless of how broadly it is applied.

Finally, and "perhaps most importantly" according to Chevron, Chevron asserts that a "substantially advance" taking claim should be viewed as distinct from a due process claim because the former generally supports a claim for compensation, whereas the latter can result in an order prohibiting government from acting at all. Chevron is half right, in the sense that, under the Court's precedents, a *proper* taking claim *should* generally support only a claim for compensation, whereas injunctive relief is an appropriate remedy for a due process violation. *See* State Br. 21-22. But Chevron is also half-wrong, because, in applying the ersatz "substantially advance" takings test, the Ninth Circuit has held that a meritorious "substantially advance" claim, just like a due process claim, entitles a claimant to injunctive relief. *See, e.g., Daniel v. County of Santa Barbara*, 288 F.3d 375, 385 (9th Cir. 2002). And, indeed, if a regulation contravened the Constitution because it failed to "substantially advance a legitimate state interest," it is entirely logical to conclude that an injunction, rather than compensation, should be the appropriate remedy. That the remedy available under the substantially advance theory, an injunction, is the same

remedy available under the Due Process Clause simply confirms that it actually *is* the due process test.[3]

B. The "Substantially Advance" Test Does Not Apply The "Character" Factor Of This Court's Regulatory Takings Test

As alternative support for the "substantially advance" taking test, Chevron argues that the enhanced means-ends scrutiny under this test can be linked to the traditional examination of the "character" of the government action in takings cases. *See* Chevron Br. 19, 20-21. According to Chevron, this version of "character" analysis serves as a threshold screen: unless demonstrably justifiable in court as a means of achieving a governmental purpose, *any* government action that diminishes property value, no matter how modestly, may be condemned as a taking. This argument should be rejected.

First, the argument is inconsistent with the Court's traditional approach to the "character" of the government action under the three-part *Penn Central* test, which is to treat it as one of several relevant factors, along with the economic impact of the regulation and the extent to which it interferes with investment-backed expectations. *See Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 123-24 (1978). Considering the character of the government action divorced from economic impact is inconsistent with the Court's strong preference for a nuanced, multi-factor approach to takings cases as opposed to a *per se* approach. *See Tahoe-Sierra Preserv. Council v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 326 (2002). It also inconsistent with the foundational idea, reflected in the traditional *Penn Central* analysis, that regulatory takings doctrine is largely concerned with identify-

[3] As the State explained in its opening brief, it would be equally illogical to conclude that compensation under the Just Compensation Clause was an appropriate remedy under the substantially advance theory. If a government action is illegitimate in a constitutional sense, payment of compensation cannot cure the constitutional defect and provide authorization for the government to proceed.

ing restrictions that, in term of the economic burdens they impose, are functionally equivalent to outright appropriations. *See* State Br. 14-15.

Similarly, Chevron mistakenly asserts that the substantially advance test comports with the fundamental purpose of the Just Compensation Clause "to bar Government from forcing some people alone to bear public burdens which, in all fair-ness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). *Armstrong* involved the government's complete destruction of property liens and establishes that, when the government singles out private property for destruction for public purposes, the government must pay compensation. But *Armstrong's* teaching is inapposite where the claim is not that the government action has imposed inordinate burdens, but that it has acted in illegitimate fashion. By contrast, the *Penn Central* test does implement the *Armstrong* principles. *See Penn Cen-tral*, 438 U.S. at 123-24 (describing the three *Penn Central* factors as having "special significance" in the "ad hoc, factual inquiries" necessary to determine when "fairness and justice" require compensation). Act 257, of course, would easily have survived a challenge under *Penn Central*, if Chevron had made one.

The Court has recognized that the character of the government action, in rare instances, may be so extraordinary that character, standing alone, may support a finding of a taking. But these special rules rest on extraordinarily severe intrusions on traditional, indeed ancient, private property rights. *See Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (describing permanent physical occupations as "perhaps the most serious form of invasion of an owner's property interests"); *Hodel v. Irving*, 481 U.S. 704, 716 (1987) (abrogation of right to pass property to one's family, part of Anglo-American legal system since feudal times).

The Court has never suggested, however, that the alleged illegitimacy of a government action is a relevant aspect of the "character" of the action, even when considered as part of the

traditional multi-factor analysis. Consistent with its generally *ad hoc* approach to the takings inquiry, the Court has not articulated an exhaustive list of the considerations that inform application of the character factor. However, the Court has generally approached the character factor as a way of gauging the nature and practical effect of the burden imposed on property owners by regulation. In *Penn Central*, for example, the Court described character as relating to whether the government action involves a physical occupation. 438 U.S. at 124. *See also Loretto*, 458 U.S. at 426 (explaining that temporary physical occupations should be analyzed under the rubric of character in a *Penn Central* analysis). The Court has also indicated that an important aspect of "character" is whether regulation applies to a broad cross-section of the community or instead singles out one or a few owners to bear a disproportionate burden. *See Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 491 (1987) (discussing "reciprocity of advantage").

But there is no authority that the alleged illegitimacy of the government action may be weighed, along with other factors, in a *Penn Central* case—and the addition of this consideration would only further complicate what is, by all accounts, already a challenging legal framework.[4] Clarifying that the "substantially advance" test (under a properly deferential standard of review) is actually a test for a due process violation will not in any way undermine the traditional *Penn Central* analysis, which remains the "polestar" of the regulatory takings analysis.

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[4] Chevron points to the *dictum* in *Penn Central* suggesting that it is somehow "implicit" in the Court's older Due Process cases that a use restriction on real property may constitute a "taking" if "not reasonably necessary to the effectuation of a substantial public purpose." 438 U.S. at 127. But this statement, which was a progenitor of the similar (although not identical) formula used a few years later in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), was not offered in the context of defining the "character" factor and actually appears several pages away in the U.S. reports from the Court's initial, now famous articulation of the *Penn Central* factors.

C. Chevron's "Causal Connection" Theory Does Not Support The "Substantially Advance" Test

Chevron argues that the "substantially advance" theory can be justified based on what it puts forward as a general principle of takings doctrine—namely that government regulation affecting property interests will be a taking unless that regulation responds to a particular social evil caused by the claimant's actual use of its property. There is no basis for this supposed principle, and in any event it could not help Chevron in this case.

As we understand Chevron's argument, Act 257 is invalid as a taking because, even though excessive rents and concentration of retail outlets for gasoline might be a problem in Hawaii in the future, they are not problems now and so there is no cause for the State to regulate Chevron's use of its property now. *See* Chevron Br. 20 (stressing the State has not claimed that the "rents *charged*" in the past to its dealers "*have been* the source of high gasoline prices," or "*have contributed* to any market concentration") (emphases added). This is a curious approach to government regulation, not to mention constitutional law, under which the State may not act to address a problem until it may well be too late to do so. The Court has repeatedly recognized the "traditional legislative authority to make predictive judgments," *Turner Broadcasting System, Inc. v. FCC*, 520 U.S. 180, 181 (1997), including the "fundamental principle of legislation" that Congress may act to prevent harm, rather than waiting its realization. *Id.* at 212. *See, e.g., McConnell v. Federal Election Comm'n*, 540 U.S. 93, 165 (2003).

When that "fundamental principle" is recognized, it becomes quite clear that Act 257 does respond to a social problem—potentially excessive rents and concentration in the retail gasoline market—that is directly related to Chevron's use of its property. As the State explained in its opening brief, the primary purpose of the rent cap imposed by Act 237 is to avert the harm to Hawaii's consumers that will occur if Chev-

ron and other oil companies raise their rents and squeeze lessee-dealers out of the retail market for gasoline, leaving that market dominated by the handful of oil companies serving the State. Thus, this legislation easily satisfies any "cause-of-the-problem" theory. *See Pennell v. City of San Jose*, 485 U.S. 1, 22 (1988) (Scalia, J., concurring in part and dissenting in part) (rent controls prohibiting excessive rents are fairly placed on landlords, since "they can plausibly be regarded as the source or the beneficiary of the high-rent problem").[5]

More fundamentally, there is no general "cause-of-the-problem" rule at work in regulatory takings doctrine. Government may act to promote the public good just as it may act to prevent harm, and whether a regulation will survive a challenge under the Just Compensation Clause does not turn on whether the regulation prevents a harm or promotes a benefit—as the Court made clear in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), where it repudiated the harm/benefit distinction for takings analysis. *See id.* at 1025-26. Nor is there any connection between Chevron's cause-of-the problem theory and the *Armstrong* principle. *Armstrong* does not address whether liability under the Just Compensation Clause should depend upon whether the government is acting to promote a public benefit or to prevent harm to the public.

Finally, Chevron attempts to invoke *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987), and *Dolan v. City of Tigard*, 512 U.S. 374 (1994), in support of its cause-of-the-problem rule. But the nexus and "rough proportionality" standards of those cases are based on the distinct principles

[5] The legislative history of Act 257 shows that the Legislature was specifically concerned that "new rent structures" proposed by oil companies would place economic pressure on the dealer network. *See* 1997 Haw. Sen. Journal 511 (statement of Sen. Baker). Thus, contrary to Chevron's argument, the immediate restraint on rent increases at eleven of Chevron's stations directly responded to the problem the legislature sought to address.

that apply to permit conditions that seek uncompensated public access to private property. As the Court subsequently made clear, those requirements, which are rooted in the unconstitutional conditions doctrine, do not apply outside the special context of exactions. *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702 (1999).

D. The "Substantially Advance" Test Conflicts With the Just Compensation Clause's Compensatory Purpose

Chevron concedes, as it must, that the fundamental purpose of the Just Compensation Clause is to provide compensation, not to block government action. Chevron Br. 33. Apparently recognizing the tension between the compensatory purpose of the clause and the type of injunctive relief that has been awarded under the "substantially advance" theory. Chevron offers the imaginative theory that its "substantially advance" claim is and has always been about obtaining compensation.

Chevron's complaint in this case, however, sought only declaratory and injunctive relief. JA 19. Until the briefing before this Court, Chevron had never suggested it sought compensation[6] and a litigant is obviously not permitted to redesign its lawsuit in this Court. Moreover, as discussed above, the decisions of the Ninth Circuit that have applied and elaborated upon this theory of takings liability have repeatedly affirmed that, unlike normal takings claims, claims under the substantially advance theory give rise to injunctive relief. *See Daniel*, *supra*. There is no denying that the "substantially advance" theory is fundamentally at odds with the compensatory purpose of the Just Compensation Clause.[7]

[6] Chevron explicitly represented to the District Court at the outset of this case that "Chevron does not seek compensation from the State of Hawaii," but instead sought a judgment preventing enforcement of Act 257. Memorandum in Support of Motion [for Summary Judgment] at 1-2, Docket No. 25 (Jan. 28, 1998).

[7] Contrary to Chevron's argument, this Court's decision in *Del Monte Dunes* does not establish that the "substantially advance" theory is consistent with the compensatory purpose of the Just Compensation Clause.

Chevron also fails to explain away the logical contradiction between the ostensible "substantially advance" theory as a test for determining whether the government has "taken" private property, and the separate "public use" requirement, which bars the government from taking property (whether by appropriation or regulation) unless that taking would be in pursuit of a legitimate governmental objective. The Court has made clear that the test for a "public use" is highly deferential, essentially identical to the test under the Due Process Clause for the exercise of the police power—and in particular, that whether a law will, or will not, be effective at accomplishing its aims is generally irrelevant to whether it serves a "public use." *See Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229, 242 (1984). If the Court were to apply a higher standard of review to the very same issue of efficacy when considering whether the law effected a "taking," the Public Use Clause would serve little function at all, for its protections would be entirely subsumed within, and duplicated by, the "substantially advance" taking analysis. Thus, it is unsurprising that the Court has assumed the same deferential standard that governs the public use requirement would apply as well to the

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The Court had no occasion to address that question in that case because (a) the City there waived its objection to the application of "substantially advance" theory, 526 U.S. at 704, and (b) the award of compensation there was supported by plaintiff's alternative taking claim that it had been denied all economic use of the property, *id.* at 701-02. The Court did rule in *Del Monte Dunes* that the claimant was entitled under the Seventh Amendment to a jury trial on its taking claim because the claimant sought a compensatory monetary remedy. *See id.* at 710-11. But the Court did *not* rule that the "substantially advance" test is a valid takings theory. *See id.* at 721-22 ("The posture of the case does not present an appropriate occasion to define with precision the elements of a temporary regulatory takings claim . . . ."). Indeed, the only Seventh Amendment ruling on which a majority of the Court agreed was that "a § 1983 suit seeking legal relief is an action at law within the meaning of the Seventh Amendment." *Id.* at 709. That ruling does not depend on the validity of any particular § 1983 claim, or any particular taking claim pursued under § 1983.

"substantially advance" issue. *See Keystone*, 480 U.S. at 487 n.11; *id.* at 511 n.3 (Rehnquist, C.J., dissenting).

Chevron suggests that it is sensible to apply two different standards of review to the same means-ends question because the public use requirement concerns whether government can proceed at all (regardless of whether compensation is paid) whereas—under Chevron's revisionist interpretation—the "substantially advance" test supposedly focuses on whether government must pay compensation as a condition of proceeding with its program. Even if Chevron's distinction had merit,[8] it would still fail to explain why, as a matter of takings law, the government's obligation to pay compensation for a taking should turn on a showing that the regulation under challenge is illegitimate. It is hard to understand why the government (a) may not act if its regulation clearly will not work at all (*i.e.*, would fail the rational-basis test), (b) may act, but must pay compensation as a condition of doing so (if the regulation has a rational basis but is invalid under a heightened means-ends standard), and (c) may act, and need not pay compensation, if the government can prove that its regulation will work (*i.e.*, would survive heightened scrutiny). This schema bears no resemblance to any familiar construct of constitutional law, and has no grounding in the basic purpose of the Just Compensation Clause to provide compensation for economically burdensome, but "otherwise proper" government actions. *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 314 (1987).

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[8] In fact, this distinction has been created out of Chevron's own imagination. As discussed above, the Ninth Circuit views the "substantially advance" test as a basis for stopping government from proceeding at all, irrespective of whether compensation is paid. *See also Yee v. City of Escondido*, 503 U.S. 519, 534 (1992) (noting that the application of the substantially advance test "does not depend on the extent to which [property owners] . . . are compensated").

E. The "Substantially Advance" Test Is Not An "Established" Part of Takings Doctrine

Finally, Chevron argues that, whatever the merits of the "substantially advance" theory, that test is an "established" part of takings law and cannot properly be reexamined now. *See* Chevron Br. 11-12, 35-39. It is correct that the Court has recited the "substantially advance" language in several of its opinions. But it is equally true, and Chevron does not dispute, that the Court has never squarely applied the test to support a finding of a taking (outside the special context of exactions), and that every single Justice has written or joined in recent opinions questioning the validity of this ostensible takings test. Simply put, the usual presumption in favor of settled law does not apply because there is no settled law to defend in this instance.

Contrary to Chevron's position, the Court's use of the "substantially advance" language in *Agins*, 447 U.S. at 260, was plainly *dictum*. Wholly apart from the fact that the unanimous Court ruled that the test was easily met, the parties in that case raised no issue about (a) whether the illegitimacy of government action could support a finding of taking, or (b) whether the zoning ordinance at issue in that case was somehow illegitimate. Thus, the language in that case upon which Chevron relies did not actually address a disputed issue, fitting the classic definition of *dictum*. As Chief Justice Marshall observed in *Cohens v. Virginia*, 19 U.S. 264, 399 (1821), "general expressions" that "go beyond the case" in which they are used "may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision." The reasons for this maxim are "obvious": whereas "the question actually before the Court is investigated with care," the implications of statements going beyond that necessary for decision may not be apparent. *Id.*

Chevron also errs in failing to recognize that *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), at least suggests the proper outcome here—namely, the "substantially advance"

inquiry is a due process test, not a takings test. The Court need not conclude (and we have not argued) that the various opinions in *Eastern Enterprises resolved* that issue. But the opinions of Justices Kennedy and Breyer (together joined by a majority of the Court), both indicate that challenges to the legitimacy of government action belong under the Due Process Clause rather than the Just Compensation Clause. *See* 524 U.S. at 545 (Kennedy, J.); *id.* at 554-56 (Breyer, J.). Chevron's attempt to dismiss those opinions as focusing on other issues represents a plain misreading. Those opinions undercut Chevron's position that the "substantially advance" test was by then firmly entrenched in takings law.[9]

II. WHETHER THE "SUBSTANTIALLY ADVANCE" INQUIRY IS A DUE PROCESS OR TAKING TEST, A DEFERENTIAL STANDARD OF REVIEW SHOULD APPLY

A. Judicial Review Of The Efficacy Of Economic Regulation Should Be Deferential, Irrespective Of The Doctrinal Framework

The second question is whether there is any basis for applying a more stringent standard of review to the means-ends fit of economic legislation under the Just Compensation Clause

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[9] The *amici* arguments are no more persuasive than Chevron's. The Richards family is correct that the substantially advance test is accurately viewed as applying the "public use" standard, which this Court, in turn, has equated with the traditionally deferential due process standard. However, the public use requirement only bars *takings* that do not serve a public use. The effort of the Richards family to convert the public use requirement into a freestanding test of whether government regulation constitutes a taking would read the word "taking" out of the Just Compensation Clause. The idea advanced by the National Association of Homebuilders that the takings and due process clauses should be viewed as fused violates the basic principle that "[w]hen two parts of a [constitutional amendment] use different language to address the same or similar subject matter, difference in meaning is assumed." *Harmelin v. Michigan*, 501 U.S. 957, 978 n.9 (1991). And Professor Epstein's argument on behalf of the Cato Institute advocating a *per se* physical occupation theory fails to recognize that the Court squarely rejected that theory in *Yee*.

(assuming that such review is even proper under that clause), than would apply to the *identical issue* under traditional principles of due process.

A heightened standard of review under the Just Compensation Clause would effectively overrule this Court's time-honored due process jurisprudence—as demonstrated by *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), which, upheld, against a due process challenge, state regulation affecting the retail gasoline industry that in many respects closely resembles the law under challenge here. In attempting to distinguish *Exxon*, Chevron argues that the statute at issue in that case did not take a property right or restrict a property's use. *See* Chevron Br. 43. But the Maryland law challenged in *Exxon* was, if anything, considerably more severe than Act 257 in its effect on property interests: the Maryland law required Exxon to *discontinue altogether* its operation of 36 gas stations in Maryland. *See* 437 U.S. at 121. The Court's conclusion that the economic regulation in *Exxon* fully satisfied due process, and its rejection of the oil companies' effort to second-guess the economic wisdom of the law, vividly demonstrates how truly incongruous the lower courts' proceedings in *this* case have been.

Chevron also attempts to evade the unmistakable teaching of the unanimous Court in *Keystone* that the Just Compensation Clause does not grant the courts "a license to judge the effectiveness of legislation." 480 U.S. at 487 n.16; *id.* at 511 n.3 (Rehnquist, J., dissenting). Chevron argues that the Court's inquiry in *Keystone* was undertaken merely to make sure that the law at issue served public rather than private purposes, and provides no guidance for the standard to be applied where the issue is whether the law may be ineffective in accomplishing its goal. Chevron Br. 41-42. To the contrary, the possibility that the Court's analysis might be read as weighing the *extent* to which the Pennsylvania law served its announced public purpose was precisely what prompted Chief Justice Rehnquist's warning against reviewing the effectiveness of

legislation, and his concern on that point was embraced by the majority of the Court. *Keystone* clearly directs the courts to avoid second-guessing the efficacy of economic regulation under the Just Compensation Clause.

B. The Just Compensation Clause Does Not Impose Any Procedural Obligation On Legislatures To Document The Harms That A Regulation Addresses

As observed above, the *de novo* review applied by the lower courts in this case represents such a startling departure from the traditional role of the courts in reviewing legislative policy judgments that Chevron does not attempt to defend it before this Court. Chevron nonetheless attempts to salvage the judgment below by suggesting that Act 257 would have been found to be a taking even under a standard that did not involve "resolving conflicting evidence or deciding which party's evidence is more persuasive." Chevron Br. 46. Chevron argues that the Hawaii legislature was required "to identify some credible evidence suggesting the likelihood of the posited harm before taking property to avert that harm." *Id.* at 49. Without such legislative fact-finding, Chevron submits, the legislature's economic judgment deserves no deference.

However, Chevron points to nothing in the Court's takings jurisprudence that supports this extraordinary, ill-defined procedural obligation on legislatures enacting economic regulations. Chevron adverts to the intermediate standard of review applied in First Amendment cases such as *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622 (1994). But the standard developed to address the special issues raised by restrictions on speech cannot logically be applied to questions about the policy wisdom of economic legislation generally. Certainly the Court has turned aside similar arguments in other contexts. *Cf. Atkins v. Parker*, 472 U.S. 115, 129-30 (1985) (rejecting argument that Due Process Clause imposes procedural constraints on legislatures); *Bi-Metallic Investment Corp. v. State Bd. of Equalization*, 239 U.S. 441, 445

(1915) (same). Moreover, the Court noted in *Dolan* that challenges under the Just Compensation Clause to generally applicable regulations are to be determined by the deferential standards adopted in the Court's traditional due process cases. 512 U.S. at 391 n.8. Under those familiar standards, the courts do not require the legislature to articulate its reasons for enacting a statute or to make any particular evidentiary showing before taking legislative action; a law will be upheld if "any state of facts, either known or which could reasonably be assumed, affords support for it." *United States v. Carolene Products Co.*, 304 U.S. 144, 154 (1938).

In any event, and as Chevron well knows, the Hawaii Legislature investigated the economic threat posed by oligopoly in the gasoline industry in Hawaii, and the particular problem posed by the need to maintain lessee-dealers as independent price-setters in the retail gasoline market, for *eight years* prior to enactment of Act 257.[10] The Legislature began its investigation after gasoline prices rose sharply in Hawaii in the wake of the *Exxon Valdez* disaster. In 1991, as the Legislature considered enacting a "divorcement" law, similar to that sustained by this Court in *Exxon*, that would have prohibited oil companies from operating their own stations, it imposed a legislative moratorium on the construction of new company-operated stations in Hawaii as an interim measure to protect lessee-dealers and consumers. 1991 Haw. Sess. Laws Act 295. That moratorium was renewed in 1993 and 1995. 1993 Haw. Sess. Laws Act 329; 1995 Haw. Sess. Laws Act 238.

Act 257, enacted in 1997, represented a classic legislative compromise. The Legislature chose not to pursue the more drastic divorcement approach, and terminated the six-year moratorium on construction of new company-operated sta-

[10] *See* 1991 Haw. Sen. Journal 322 (remarks of Senator Ikeda) (observing that the number of independent dealers had declined from 600 in 1979 to less than 300 in 1991, and urging steps to prevent gasoline marketing from becoming "a total monopoly.").

tions. Instead, the Legislature enacted a multi-pronged bill that included requirements for collecting information regarding the gasoline market, prohibitions on conversion of leased stations, and the rent cap at issue in this case. The Legislature held three hearings on the proposed law, at which Chevron among others presented written statements.[11] The floor debates dealt with the economic arguments for and against the legislation; significantly, these arguments were essentially the very same arguments later reprised before the federal district court in this case.[12] The law's enactment demonstrated the Legislature's determination to "foster competition in the marketplace," 1997 Haw. Sen. Journal 511 (remarks of Senator Baker), and its concern that high lease rents might put economic pressure on lessee dealers, forcing them out of the retail market.[13]

Chevron asserts, nonetheless, that there is no evidence of any real threat that it, or other oil companies, might attempt to displace its lessee-dealers, and denies having any incentive to do so. The economic self-interest that oil companies have in increasing their direct sales of gasoline and eliminating mid-

[11] *See, e.g.*, 1997 Haw. Sen. Journal 511 (remarks of Senator Baker) (noting that the committee had made a "concerted effort to obtain as much information as possible so we could make an informed decision," including informational briefings and public hearing); Sen. Stdg. Comm. Rep. No. 1528, 1997 Haw. Sen. Journal 1472 (noting committee had held hearings on H.B. No. 1451).

[12] *See, e.g.*, 1997 Haw. House Journal at 926-28 and 1997 Haw. Sen. Journal at 510-12.

[13] *See, e.g., id.* at 771 (remarks of Senator Baker) (noting that bill addressed concerns of dealers "who feared that they would be forced out of the market due to the potential predatory actions of manufacturers"); 1997 Haw. House Journal 926 (remarks of Rep. Yoshinaga) (bill protects dealers from being driven out of business by "excessively high rents"). The legislative history shows that, in addition to its goal of preserving a competitive retail marketplace, the Hawaii legislature was concerned about preserving the wide range of services traditionally offered by lessee dealers. *See, e.g.*, 1997 Haw. Sen. Journal 510-12 (remarks of Senators Kawamoto, Baker and Anderson).

dlemen is well-recognized, however, and was acknowledged in the evidence at trial. JA 115, 120. The Petroleum Marketing Practices Act (PMPA) was enacted by Congress because of similar concerns. *See* S. Rep. No. 95-731, at 21-25 (1978) (describing concerns for consumer welfare from increasing dominance of company-operated stations and risk that economic power of wholesaler "can be used to eliminate independent buyers"). The PMPA was amended in 1994 to restrain oil companies from intentionally converting their dealer operations to company stations, after the Senate Judiciary Committee documented the oil companies' repeated and flagrant use of economic pressure, including confiscatory rents, to drive independent dealers out of business. *See* State Br. 3 n.1. *See also* Br. of Service Station Dealers of America. To describe Hawaii's effort to address the same problem as "irrational" is entirely specious.[14]

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

[14] Chevron argues that the *other* protective provisions of Act 257, precluding location of company-operated stations in proximity to lessee-dealer stations and permitting company operation of lessee dealer stations only for limited periods, render the protection afforded by the rent cap unnecessary. The legislature is entitled to adopt overlapping measures, however, to ensure that the public is protected. The other measures in Act 257 would afford little real protection for the retail marketplace if independent dealers were squeezed out by high rents, even if the oil companies were hindered in moving into their locations.

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No. 04-163

In the Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, AND MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII, PETITIONERS

v.

CHEVRON USA INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether a state law limiting the rent that oil refiners may charge their lessee-dealers may be held invalid under the Just Compensation Clause based on a district court's finding that the law is unlikely to achieve its consumer-protection objectives.

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INTEREST OF THE UNITED STATES

This case concerns a challenge under the Just Compensation Clause of the Fifth Amendment to a state law that limits the amount of rent that oil companies may charge lessees of company-owned service stations. The federal government administers many programs that restrict the use of private property in order to protect human health, public safety, the environment, and other important interests. The United States has a substantial interest in the sound development of the relevant constitutional analysis in cases that may affect its ability to implement those programs consistent with constitutional protections for private property.

STATEMENT

1. "Because Hawaii is a physically small and geographically remote economy, certain of its markets tend to be concentrated." Act 257 § 1(4), 1997 Haw. Sess. Laws 561, codified in part at Haw. Rev. Stat. Ann. § 486H-10.4 (Michie 1998 & Supp. 2003). The wholesale market for gasoline is one

such market. In 1997, when the law at issue in this case was enacted, only two refineries and six gasoline wholesalers were doing business in the State. See Pet. App. 35. As the Hawaii Legislature found in enacting the challenged statute, prices in highly concentrated markets tend to rise above competitive levels, resulting in harm to consumers and the public. Act 257, § 1(4)-(5), 1997 Haw. Sess. Laws 561.

Act 257 represents the Hawaii Legislature's effort to protect consumers against supracompetitive retail prices for gasoline. Although the wholesale gasoline market in Hawaii is highly concentrated, the retail gasoline market includes numerous participants, including company-operated stations, which are owned and operated by oil companies marketing their own products; lessee-dealer stations, which are leased by retail dealers from oil companies; and independent stations, which are neither owned by nor leased from oil companies. Act 257 seeks to prevent oil companies from projecting their market power as wholesale dealers into the retail gasoline market, with the ultimate aim of protecting consumers against increased gas prices. See Pet. App. 33-35, 106-108.

Act 257 contains several provisions that are intended to protect the competitive position of lessee-dealer and independent gas stations. The Act prohibits an oil company from converting a lessee-dealer service station to a company-operated station, and from opening a new company-owned service station in close proximity to an existing dealer station. See Haw. Rev. Stat. Ann. § 486H-10.4(a) and (b) (Michie 1998 & Supp. 2003). The Act also limits the amount of rent that an oil company may charge a lessee-dealer for leasing a company-owned station, and it requires a lease term of at least three years. See § 486H-10.4(c). The maximum rent is tied to the volume of and profits on retail sales: under the Act, the rent may not exceed 15% of gross sales

for products other than gasoline, plus 15% of gross profit for gasoline sales. See *ibid.*; Pet. App. 3.[1]

2. Respondent Chevron USA Inc. "is one of two gasoline refiners and one of six wholesalers in Hawaii. At the retail level, [respondent] sells most of its gasoline through company-owned stations, which are leased to independent dealers." Pet. App. 2. If Act 257 had not been enacted, respondent would charge its lessee-dealers a monthly rent calculated as "an escalating percentage of the dealer's gross margin on actual * * * gasoline sales," which at least in some instances might be greater than the 15% maximum that the Act allows. *Id.* at 2-3. Respondent has not historically been able fully to recoup its own expenses relating to dealer stations through the rents paid by lessee-dealers, but instead has "relie[d] on its supply contracts to earn a profit." *Id.* at 3. "Dealers who choose to rent a station from Chevron must as a condition of their lease agree to purchase from Chevron all the product necessary to satisfy demand at the station for Chevron gasoline." *Ibid.* The wholesale price of gasoline de-

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[1] The apparent purpose of that rent-control provision is to maximize competition in the retail gasoline market by prohibiting the imposition of exorbitant rents that might have the effect of driving lessee-dealers out of business. See Pet. 2. The Petroleum Marketing Practices Act (PMPA), 15 U.S.C. 2801 *et seq.*, limits the grounds on which gasoline franchisors may terminate or fail to renew existing franchises. See 15 U.S.C. 2802(a). A gasoline company may decline to renew an existing franchise based on the parties' failure to agree to terms of renewal (15 U.S.C. 2802(b)(3)(A)), so long as any new terms imposed by the company "are the result of determinations made by the franchisor in good faith and in the normal course of business" (15 U.S.C. 2802(b)(3)(A)(i)), and those terms are not imposed "for the purpose of converting the leased marketing premises to operation by employees or agents of the franchisor for the benefit of the franchisor or otherwise preventing the renewal of the franchise relationship" (15 U.S.C. 2802(b)(3)(A)(ii)). Although that provision bars gasoline companies from imposing rent increases *for the purpose* of inducing lessee-dealers to leave the market, it does not otherwise restrict the rents the lessors may charge. Act 257, by contrast, establishes a maximum rent that is determined by a mathematical formula and that does not depend on the intent of the refiner.

livered to the dealers "is unilaterally set by Chevron" (*ibid.*) and is not regulated by Act 257.

Respondent's complaint alleged, *inter alia*, that Act 257 effected an unconstitutional taking of its property. Respondent did not allege that it would suffer exorbitant economic loss as a result of the Act's restrictions on the rents it may charge its lessee-dealers; indeed, respondent stipulated that, taking into account profits from gasoline sales, it "has earned in the past and anticipates that it will earn in the future, at the rent levels allowed by Act 257, a return that satisfies any Constitutional standards on its investment in lessee dealer stations in Hawaii." J.A. 40; see Pet. App. 38-39. Rather, respondent argued that Act 257 effected an unconstitutional taking because the Act would not actually achieve its consumer-protection objectives.

3. The district court granted respondent's motion for summary judgment on its claim under the Just Compensation Clause. Pet. App. 94-118. The court stated that, "in order to determine whether the Act effects a taking, the appropriate inquiry is whether the Act substantially advances a legitimate state interest, not merely whether the legislature rationally believed it would do so." *Id.* at 106. The court found that, although the State's ultimate objective was to protect consumers from higher retail gasoline prices, the Act could achieve that objective only if it benefitted lessee-dealers. See *id.* at 107-108. The court concluded that the Act would not protect new lessee-dealers because incumbent dealers could capture the value of the reduced rent in the form of a premium by transferring their occupancy rights to others, *id.* at 108-112, and that it would not help incumbent dealers because oil refiners could offset the rent reductions with corresponding increases in wholesale petroleum prices, *id.* at 113-117.

4. The court of appeals vacated the grant of summary judgment and remanded for trial. Pet. App. 54-93. The court held that the district court had applied the correct

legal test, and it rejected the State's contention that respondent's takings claim should be addressed under the deferential standard that applies when economic regulation is challenged under the Due Process Clause. See *id.* at 58-66. The court of appeals held, however, that summary judgment was inappropriate because genuine issues of fact existed as to whether the Act "will in fact lead to lower fuel prices." *Id.* at 76; see *id.* at 66-77. The court stated that "conflicting predictions" contained in the declarations of the parties' experts precluded an award of summary judgment, and that live testimony with cross-examination was necessary "[i]n order to determine whose predictions are more accurate." *Id.* at 72.

Judge William A. Fletcher concurred in the judgment. Pet. App. 79-93. Judge Fletcher agreed that the district court's grant of summary judgment for respondent should be reversed, but he would have remanded the case with instructions that the district court apply the same "reasonableness" standard that would govern a Due Process Clause challenge to rent-and price-control laws. See *id.* at 80-81.

5. On remand, the district court conducted a one-day trial and then entered findings of fact and conclusions of law. Pet. App. 30-53. Based on the substance of the testimony and the demeanor of the witnesses, the court found the testimony of respondent's expert that Act 257 would lead to an increase in wholesale gasoline prices to be "more persuasive" than the contrary testimony of the State's expert. *Id.* at 43. The court also found as fact that "Act 257 will not advance its stated interest of lowering consumer gasoline prices" because lessee-dealers "will pocket the savings for themselves" rather than pass those savings along to consumers. *Id.* at 44. The court "disagree[d]" with the view of the State's expert that dealer uncertainty about a variety of factors—including "future rent, future gasoline margins, and stations' sales of products other than gasoline"—would prevent lessee-dealers from capturing a premium. *Id.* at 45. The district court concluded that the Act "effects an uncon-

stitutional regulatory taking" because its "imposition of a cap on the rent that an oil company may charge a lessee-dealer does not substantially advance the State's legitimate interest in lowering gasoline prices." *Id.* at 53.

6. The court of appeals affirmed. Pet. App. 1-29. The court held that the State's challenge to the legal standard applied by the district court was barred by "law of the case" principles. *Id.* at 5-17. The court of appeals sustained the district court's application of that standard to the facts of this case, concluding that "[t]he court's factual findings and conclusions of law are consistent with the views of the parties' experts and are not clearly erroneous." *Id.* at 21. Judge Fletcher dissented, *id.* at 25-29, adhering to the view expressed in his prior opinion that the "substantially advance[]" test is inapplicable to rent-control legislation, see *id.* at 25-26.

SUMMARY OF ARGUMENT

A. In reviewing due process and equal protection attacks on federal or state economic legislation, courts apply a highly deferential standard under which the challenged law will be sustained if a reasonable legislator could believe that it will serve a legitimate public purpose. This Court has applied that deferential standard to due process and equal protection challenges to a variety of price-control laws, including those addressed to rents.

B. During the era commonly associated with *Lochner* v. *New York*, 198 U.S. 45 (1905), this Court frequently invoked the Due Process Clause and a less deferential standard of review to invalidate economic legislation. The Court subsequently repudiated those decisions as inconsistent with the limited role of the judiciary. The Court has relied on the same principles of judicial restraint in applying a highly deferential standard of review when economic legislation is challenged under the Equal Protection Clause. Those principles would be substantially undermined if plaintiffs could obtain heightened scrutiny by bringing challenges to the efficacy of routine economic regulatory legislation under the Just Compensation Clause.

C. Disputes concerning the efficacy of economic legislation have no bearing on the question whether such legislation effects a taking. The paradigmatic taking is a direct appropriation of land under the government's power of eminent domain. Compensation is required in that setting, and in other cases involving physical takings, to ensure that the costs of achieving public objectives are equitably spread throughout the community rather than unfairly concentrated on discrete property owners. The Court's regulatory takings jurisprudence reflects an effort to identify other government actions that impose such disproportionate burdens on particular regulated persons as to constitute the functional equivalent of an appropriation of property. Respondent's contention that Act 257 will fail to achieve its consumer-protection objectives does not implicate the Just Compensation Clause because the efficacy of Act 257 is logically irrelevant to the question whether respondent will bear a disproportionate share of the burdens the Act entails. Indeed, additional legislative measures to make Act 257 more efficacious might well impose greater burdens on respondent. The decisions of the courts below to enjoin the enforcement of Act 257, rather than to order the payment of just compensation, further demonstrate that their rationale for finding a taking is inconsistent with established Just Compensation Clause jurisprudence.

D. The court of appeals' approach to this case is in no way compelled by this Court's precedents. Although several of this Court's decisions contain passing references to the "substantially advance" standard, the Court has never found a taking based on doubt as to the likely efficacy of economic regulation. And, in any event, because the phrase "substantially advance" has its roots in due process jurisprudence, the Court's use of the phrase in the takings context provides

no basis for the Ninth Circuit's rejection of the "rational basis" standard in this case. Finally, cases in which the right to develop land is conditioned on the dedication of a public easement—a permanent physical occupation of real property for which the Constitution would ordinarily require the payment of just compensation—present distinct problems, and the constitutional rules that govern in that setting are inapplicable here.

ARGUMENT

IN REFUSING TO DEFER TO THE HAWAII LEGISLATURE'S DETERMINATION THAT ACT 257 WILL PRESERVE COMPETITION IN THE RETAIL GASOLINE MARKET, AND IN ORDERING A TRIAL TO ASSESS ACT 257'S LIKELY EFFICACY, THE COURT OF APPEALS MISAPPLIED THIS COURT'S PRECEDENTS AND IGNORED IMPORTANT LIMITS ON THE PROPER ROLE OF THE JUDICIAL BRANCH

In several decisions beginning with *Agins* v. *City of Tiburon*, 447 U.S. 255, 260 (1980), this Court has stated without elaboration that a restriction on the use of property may effect a taking if it does not "substantially advance" a legitimate governmental interest. Relying on those statements and on their Ninth Circuit progeny, the court of appeals directed the district court to conduct a trial to determine whether Act 257 would actually produce the benefits to consumers that the state legislature had anticipated. After the district court held the mandated trial and found that Act 257 would not achieve its consumer-protection objectives, the court of appeals sustained that finding as not clearly erroneous and affirmed the district court's injunction against the Act's enforcement.

The court of appeals' approach is badly mistaken for two distinct reasons. First, as we demonstrate in Parts A and B, *infra*, this Court's unwillingness to second-guess legislative judgments through evidentiary hearings, and the resulting

deferential "rational basis" standard that governs due process and equal protection challenges to economic legislation, reflect long-settled principles of judicial restraint and relative institutional competence. Those principles would be substantially undermined if heightened scrutiny of such legislation were available under the Just Compensation Clause. Second, as we explain in Part C, *infra*, Just Compensation Clause analysis *presupposes* that the relevant government action is a reasonable means of achieving some legitimate public purpose, and seeks to identify those regulatory measures that will impose such disproportionate burdens on discrete property owners as to render those measures the functional equivalent of an exercise of eminent domain. Questions concerning Act 257's likely *efficacy* are logically irrelevant to that inquiry, and indeed more efficacious regulation might well produce a greater burden.

Finally, we show in Part D, *infra*, that the court of appeals' approach is in no way compelled by this Court's precedents. The "substantially advance" test was derived from this Court's due process jurisprudence, and the Court has never invoked that test to find a taking of property based on doubt that economic or land-use regulation, in fact, would achieve its desired objectives.

A. In Reviewing Due Process And Equal Protection Challenges To Economic Legislation, Including Price-Control Laws, Courts Must Give Great Deference To The Policy And Predictive Judgments Of Legislative Officials

During the past several decades, this Court has repeatedly held that, when federal or state economic legislation is challenged under the Due Process Clause of the Fifth or Fourteenth Amendment, courts must apply a highly deferential standard under which the law will be sustained if a reasonable legislator could believe that it will serve a legitimate public purpose. "It is by now well established that leg-

islative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way." *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976). A similarly deferential standard applies when such legislation is challenged under the Equal Protection Clause of the Fourteenth Amendment or the equal protection component of the Fifth Amendment. See, *e.g.*, *FCC* v. *Beach Communications, Inc.*, 508 U.S. 307, 313 (1993) ("In areas of social and economic policy, a statutory classification that neither proceeds along suspect lines nor infringes fundamental constitutional rights must be upheld against equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification."); *Williamson* v. *Lee Optical Co.*, 348 U.S. 483, 488-489 (1955).

That highly deferential standard applies with full force to due process and equal protection challenges to price-control laws, including those that regulate the prevailing rent for real property. Thus, in *Nebbia* v. *New York*, 291 U.S. 502 (1934), the Court sustained a state law setting minimum and maximum prices for the retail sale of milk. See *id.* at 515, 539. The Court explained that "[i]f the laws passed are seen to have a reasonable relation to a proper legislative purpose, and are neither arbitrary nor discriminatory, the requirements of due process are satisfied." *Id.* at 537; see *id.* at 539 ("Price control, like any other form of regulation, is unconstitutional only if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt."), quoted in *Permian Basin Area Rate Cases*, 390 U.S. 747, 769-770 (1968). In *Pennell* v. *City of San Jose*, 485 U.S. 1, 11-13 (1988), the Court recognized the continuing validity of that standard for reviewing due process challenges to price-control legislation, and it applied that standard to a municipal ordinance controlling rents. The Court in *Pennell* also

rejected the plaintiffs' equal protection challenge to the rent-control law, reviewing it only for a rational basis. See *id.* at 14-15. Thus, if respondent had pursued a Due Process or Equal Protection Clause challenge to Act 257, the court of appeals would have reviewed the Act under a highly deferential standard and could not properly have ordered a trial on the question whether the law would actually achieve its consumer-protection objectives.

B. Respondent's Request For Heightened Scrutiny Of Act 257's Achievement Of Its Goals Is Inconsistent With The Principles Of Judicial Restraint And Legislative Preeminence In Economic Affairs That Underlie This Court's Due Process And Equal Protection Jurisprudence

The important constitutional principle reflected in the decisions cited above would be substantially undermined if a plaintiff in respondent's position could obtain a more favorable standard of review of a law's efficacy simply by recasting its constitutional challenge as a takings claim.[2] Respondent seeks to escape the force of those precedents by arguing that a deferential standard of review applies in due process cases only because "[t]he Due Process Clause is directed primarily toward ensuring the adequacy of *procedural* safeguards in protecting personal interests generally." Br. in Opp. 18. That argument ignores the historical development of this Court's due process jurisprudence and the

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[2] Even assuming that Act 257 is a rational means of protecting consumer interests and therefore would satisfy due process and equal protection scrutiny, its character as a rent-control measure might still be relevant to a claim under, *e.g.*, *Penn Cent. Transp.* v. *City of New York*, 438 U.S. 104 (1978), that the Act effects a taking by imposing exorbitant *burdens* on individual property owners. See pp. 16-19, *infra*; but cf. note 5, *infra*. But respondent has not pursued such a claim, see pp. 19-20, *infra*; cf. *Pennell*, 485 U.S. at 8-11 (finding takings claim unripe), and its challenge to the *efficacy* of Act 257 should not be analyzed under any test more demanding than the rational-basis standard.

justifications that the Court has given for its highly deferential review of laws regulating economic affairs.[3]

1. During the era commonly associated with *Lochner* v. *New York*, 198 U.S. 45 (1905), this Court closely scrutinized (and frequently invalidated) legislation under the Due Process Clause. See, *e.g.*, *Ferguson* v. *Skrupa*, 372 U.S. 726, 729 (1963) ("There was a time when the Due Process Clause was used by this Court to strike down laws which were thought unreasonable, that is, unwise or incompatible with some particular economic or social philosophy."). This Court's rejection of that approach in favor of the highly deferential standard in due process cases was an epochal shift that reflected deeply held views about the proper role of courts in our system of government. See, *e.g.*, *ibid.* ("Under the system of government created by our Constitution, it is up to legislatures, not courts, to decide on the wisdom and utility of legislation."); *Nebbia*, 291 U.S. at 537 ("With the wisdom of the policy adopted [in a law regulating economic affairs], with the adequacy or practicability of the law enacted to forward it, the courts are both incompetent and unauthorized to deal."). In light of this Court's own explanations for its repudiation of *Lochner* and associated decisions, it is ahistorical to suggest that the mistake made by plaintiffs and courts during the *Lochner* era was simply that they grounded their attacks in the wrong Clause of the Constitution.

[3] In addition to its potential impact on economic and land-use *legislation*, the Ninth Circuit's decision in this case has significant implications for judicial review of federal agency action. In conducting review under the Administrative Procedure Act (APA), 5 U.S.C. 706(2)(A) (authorizing court to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"), a court owes substantial deference to the technical judgments of an expert agency acting pursuant to a grant of authority from Congress. See, *e.g.*, *Marsh* v. *Oregon Natural Res. Council*, 490 U.S. 360, 377 (1989) (Where "analysis of the relevant documents requires a high level of technical expertise, [courts] must defer to the informed discretion of the responsible federal agencies.") (citation and internal quotation marks omitted). If the rent-control measure at issue here had been adopted by a federal agency pursuant to congressional authorization, a court in conducting APA review could not properly hold a trial to determine whether the restriction would advance consumer interests. The court of appeals' decision here, if affirmed by this Court, would open the door to more intrusive review of agencies' technical judgments under the Just Compensation Clause than is currently available under the APA's "arbitrary and capricious" standard, in contravention of established administrative law principles. Cf. *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (Federal Power Commission's rate order "is the product of expert judgment which carries a presumption of validity," so that "he who would upset the rate order under the [Natural Gas] Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences."); *id.* at 607 ("Since there are no constitutional requirements more exacting than the standards of the Act, a rate order which conforms to the latter does not run afoul of the former.").

The preeminence of legislative authority in the sphere of economic policy rests in part on the fact that legislators are popularly elected and are therefore accountable to the public. See, *e.g.*, *Ferguson*, 372 U.S. at 730 ("We have returned to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws."). It also reflects this Court's recognition that judges typically lack both the fact-gathering capabilities and the technical expertise that Congress and the state legislatures possess (or can gain access to) in their formulation of public policy. See, *e.g.*, *American Commercial Lines, Inc.* v. *Louisville & Nashville R.R.*, 392 U.S. 571, 590 (1968) ("The courts are ill-qualified indeed to make the kind of basic judgments about economic policy sought by the railroads here.").[4] Finally, where re-

[4] Even in circumstances where an Act of Congress is subject to intermediate scrutiny, as when media regulation significantly implicates First Amendment interests, see *Turner Broad. Sys., Inc.* v. *FCC*, 520 U.S. 180, 185 (1997), a reviewing court "must accord substantial deference to the predictive judgments of Congress," *id.* at 195. That deference rests in part on the fact that Congress "is far better equipped than the judiciary to amass and evaluate the vast amounts of data bearing upon legislative questions." *Ibid.* (citation and internal quotation marks omitted). Deference is also appropriate to ensure that the reviewing court does not

view of state legislation is concerned, a deferential standard furthers principles of federalism by ensuring that "a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country." *New State Ice Co.* v. *Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

Each of the concerns described above would be directly implicated if heightened judicial scrutiny of the efficacy of state legislation were available in suits brought under the Just Compensation Clause. To allow a plaintiff in respondent's position to obtain a more favorable standard of review simply by repackaging its challenge as a Just Compensation Clause claim is inconsistent with this Court's repeated admonitions that the deferential standard of review that generally applies in due process challenges rests on fundamental principles concerning the Constitution's allocation of power between legislatures and courts.[5]

"infringe on traditional legislative authority to make predictive judgments when enacting nationwide regulatory policy." *Id.* at 196.

[5] The court of appeals did not make clear precisely what category of regulatory activities it believed should be subject to heightened scrutiny under the "substantially advance" standard—*i.e.*, whether that scrutiny applies to economic regulation generally, or only to regulation that has a particular connection to the use of real property. If the Ninth Circuit's decision is given the broader reading, it would suggest (for example) that a district court could conduct a trial to assess the Sherman Act's likely efficacy if a plaintiff alleges (as some scholars believe, see, *e.g.*, Richard A. Epstein, *Simple Rules for a Complex World* 126-127 (1995)) that the Act disserves the interests of consumers and therefore does not "substantially advance" a legitimate governmental objective. It is hard to imagine that the court of appeals intended to endorse that result. But because the Just Compensation Clause prohibits uncompensated takings of private *property*, not simply uncompensated takings of *land*, the text of the Clause does not furnish a ready basis to differentiate for these purposes between regulation of the rent that respondent charges its lessee-dealers and (hypothetical) regulation of the price it charges for wholesale deliveries of gasoline. Cf. note 3, *supra*, and note 7, *infra*; but cf. *Lucas* v. *South Carolina Coastal Council*, 505 U.S. 1003, 1027-1028 (1992). Such a distinction also appears inconsistent with this Court's holdings that, for due

2. This Court also applies a highly deferential standard when challenges to state and federal regulations that do not implicate fundamental rights or suspect classes are brought under the Equal Protection Clause. See, *e.g.*, *Beach Communications*, 508 U.S. at 313 (equal protection challenge to such regulation fails "if there is any reasonably conceivable state of facts that could provide a rational basis for the classification"); see also *Village of Willowbrook* v. *Olech*, 528 U.S. 562, 564-565 (2000) (equal protection challenge to regulation of residential property). As in its decisions applying the Due Process Clause, the Court has justified that approach by emphasizing the limited role of courts in a democratic society. See, *e.g.*, *id.* at 314 (deferential standard in equal protection cases "is a paradigm of judicial restraint"); *Vance* v. *Bradley*, 440 U.S. 93, 97 (1979) ("The Constitution presumes that, absent some reason to infer antipathy, even improvident decisions will eventually be rectified by the democratic process and that judicial intervention is generally unwarranted no matter how unwisely we may think a political branch has acted.") (footnote omitted). The Court's application of that standard to equal protection challenges, and its invocation of the same principles of judicial restraint that animate its substantive due process jurisprudence, further undermine respondent's contention that the deferential review conducted in Due Process Clause cases rests on the procedural focus of that Clause.

C. Disputes Concerning The Likely Efficacy Of Economic Regulation Are Irrelevant To The Just Compensation Clause Inquiry

Respondent suggests (Br. in Opp. 18) that heightened scrutiny of Act 257 is appropriate because the Just Compensation Clause is the constitutional provision whose purposes

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process and equal protection purposes, rent-control laws should be reviewed under the same deferential "rational basis" standard that applies to other economic legislation. See pp. 10-11, *supra*.

are most directly implicated by challenges to allegedly ineffective economic regulation. That contention reflects a fundamental misunderstanding of the just compensation requirement and of this Court's regulatory takings jurisprudence. Far from lying at the core of the Just Compensation Clause inquiry, disputes concerning the likely efficacy of economic regulation are *irrelevant* to the question whether such regulation effects a taking.

1. As this Court recognized in *Lucas* v. *South Carolina Coastal Council*, 505 U.S. 1003, 1028 n.15 (1992), "early constitutional theorists did not believe the Takings Clause embraced regulations of property at all." Rather, "it was generally thought that the Takings Clause reached only a 'direct appropriation' of property, or the functional equivalent of a 'practical ouster of [the owner's] possession.'" *Id.* at 1014 (citations omitted). The requirement that just compensation be paid when the government appropriates real property does not rest on the proposition that appropriation of land is an ineffective means of advancing legitimate governmental objectives. To the contrary, payment of compensation when the government exercises the power of eminent domain presupposes that the government could rationally conclude that the appropriation would serve such objectives, and would therefore satisfy the "public use" precondition for a taking. See p. 21 & note 10, *infra*. The mandate that just compensation be paid instead ensures that the costs of achieving the government's objectives are equitably spread across the community, rather than being unfairly concentrated on the discrete individuals who own the particular tracts that the government has concluded should be obtained to carry out its program. See, *e.g.*, *Armstrong* v. *United States*, 364 U.S. 40, 49 (1960) (just compensation requirement "was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole").

2. Since the early 20th Century, this Court has held that land-use regulation may sometimes intrude so severely upon the prerogatives that have traditionally accompanied ownership of real property that it should be treated as a compensable taking, even though the owner retains title to and possession of the land, and even if no physical intrusion onto the property occurs. See, *e.g.*, *Tahoe-Sierra Pres. Council, Inc.* v. *Tahoe Reg'l Planning Agency*, 535 U.S. 302, 322 n.17 (2002) (regulatory taking occurs when "a law or regulation imposes restrictions so severe that they are tantamount to a condemnation or appropriation"); *Lucas*, 505 U.S. at 1014-1019; *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 413 (1922). Thus, regulation that deprives the owner of all economically beneficial use of the land requires the payment of just compensation unless the proscribed uses are reasonably regarded as not part of the property to begin with (due, for example, to background principles of nuisance law). See *Lucas*, 505 U.S. at 1014-1016, 1027, 1029.

The core justification for requiring the payment of compensation in that situation is that, when regulation renders a parcel of real property essentially valueless, its practical impact on the landowner is the functional equivalent of a condemnation. In *Mahon*, for example, a state law essentially eliminated a coal company's separate "support estate" in the land that it had acquired to allow it to mine coal. See 260 U.S. at 414-415. The Court explained that in those circumstances, "[t]o make it commercially impracticable to mine certain coal has very nearly the same effect for constitutional purposes as appropriating or destroying it." *Id.* at 414; see *Lucas*, 505 U.S. at 1017 (noting that "total deprivation of beneficial use is, from the landowner's point of view, the equivalent of a physical appropriation."). "The principle that underlies this doctrine is that, while most burdens consequent upon government action undertaken in the public interest must be borne by individual landowners as concomitants of the advantage of living and doing business in a civi-

lized community, some are so substantial and unforeseeable, and can so easily be identified and redistributed, that justice and fairness require that they be borne by the public as a whole." *Kirby Forest Indus., Inc.* v. *United States*, 467 U.S. 1, 14 (1984) (footnote and internal quotation marks omitted).

As when regulation renders a parcel of land valueless, just compensation must also be paid when the government requires a landowner to accept a permanent physical occupation of his real property. See *Dolan* v. *City of Tigard*, 512 U.S. 374, 384 (1994); *Nollan* v. *California Coastal Comm'n*, 483 U.S. 825, 831-832 (1987); *Loretto* v. *Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426, 434-435, 441 (1982). That rule likewise rests on the Court's recognition that a permanent physical occupation places a particularly severe burden upon the landowner. See *id.* at 435 (explaining that "a permanent physical occupation of another's property * * * is perhaps the most serious form of invasion of an owner's property interests" because "it effectively destroys *each* of [the] rights" associated with ownership). The more ad hoc multi-factor approach described in *Penn Central Transportation Co.* v. *City of New York*, 438 U.S. 104 (1978), is similarly designed to "determin[e] when justice and fairness require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons." *Id.* at 124 (internal quotation marks omitted); see *Palazzolo* v. *Rhode Island*, 533 U.S. 606, 617-618 (2001).[6]

[6] Cf. *Eastern Enters.* v. *Apfel*, 524 U.S. 498, 537 (1998) (plurality opinion) (concluding that monetary assessment imposed on current mine operators by the Coal Act effected a taking because the Act "single[d] out certain employers to bear a burden that is substantial in amount, based on the employers' conduct far in the past, and unrelated to any commitment that the employers made or to any injury they caused"). Five Justices in *Eastern Enterprises* concluded that the plaintiff's challenge to the Coal Act assessment was more appropriately considered under the Due Process Clause. See *id.* at 539-547 (Kennedy, J., concurring); *id.* at 554-558 (Breyer, J., dissenting). Unlike respondent's challenge to Act 257,

Thus, the various tests employed by this Court to determine whether land-use regulation "goes too far," *Mahon*, 260 U.S. at 415, and therefore should be treated as a compensable taking, reflect a common objective. Each test represents a means of identifying those regulatory measures that are analogous to the exercise of eminent domain—*i.e.*, those regulatory measures whose *burdens* are unfairly concentrated on discrete property owners. Respondent does not contend that Act 257 will render any parcel of land valueless, and indeed has acknowledged that it cannot establish a taking based on anticipated economic harm. See J.A. 40 (respondent stipulates that it "has earned in the past and anticipates that it will earn in the future, at the rent levels allowed by Act 257, a return that satisfies any Constitutional standards on its investment in lessee dealer stations in Hawaii").[7] This Court has squarely held that

however, which is grounded in the alleged inefficacy of the law, the constitutional claim in *Eastern Enterprises* at least implicated the Just Compensation Clause's central purpose of ensuring that the costs of public programs are distributed in an equitable manner. See *id.* at 537 (plurality opinion) (Coal Act assessment "implicates fundamental principles of fairness underlying the Takings Clause"); cf. *Pennell*, 485 U.S. at 20-22 (Scalia, J., concurring in part and dissenting in part). Thus, even under the approach of the *Eastern Enterprises* plurality, see 524 U.S. at 522-537, respondent's efficacy challenge does not state a valid takings claim.

[7] If respondent had based its takings claim on Act 257's anticipated economic impact, a court in reviewing that challenge would have been required to consider respondent's potential earnings from gasoline sales to lessee-dealers as well as its rental income. See *West Ohio Gas Co.* v. *Public Utils. Comm'n*, 294 U.S. 63, 70 (1935) (Under the Due Process Clause, the Court's sole "inquiry in rate cases coming here from the state courts is whether the action of the state officials in the totality of its consequences is consistent with the enjoyment by the regulated utility of a revenue something higher than the line of confiscation."). See also *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 310 (1989) (Court acknowledged in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), that "all of the subsidiary aspects of valuation for ratemaking purposes could not properly be characterized as having a constitutional dimension, despite the fact that they might affect property rights to some degree."). The approach adopted by the Ninth Circuit improperly allows a party

rent-control laws do not effect a compelled physical occupation of land, see *Yee* v. *City of Escondido*, 503 U.S. 519, 530-531 (1992), and respondent has not pursued a claim under *Penn Central*.[8] Respondent has thus failed to establish a taking under *any* of the tests employed by this Court to determine whether the *burdens* imposed by government action are so severe and disproportionate as to require the payment of just compensation.

Respondent has instead argued, and the court of appeals agreed, that Act 257 effects a taking because the law will not "substantially advance" the State's legitimate interest in preventing increases in retail gasoline prices. The contention that Act 257 will fail to achieve its consumer-protection objectives, however, is logically irrelevant to the question whether respondent has been forced to bear a disproportionate share of the financial burdens the Act entails. Indeed, any effort by the Hawaii Legislature to make Act 257 more efficacious, by, for example, imposing parallel limits on the wholesale price of gasoline, would only impose greater burdens on respondent.

The district court's finding that Act 257 is likely to be inefficacious therefore does not remotely suggest that the Act is the functional equivalent of an exercise of eminent domain.

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challenging a rate- or price-control regime to avoid the requirement of showing that the overall impact is confiscatory, and instead to pick off subsidiary elements on the ground that they are inefficacious. Allowing such a claim is particularly anomalous in this case because at least one of the concerns about Act 257's efficacy stems from the Legislature's failure to limit respondent's wholesale prices, in addition to its rents.

[8] Because respondent has not alleged a taking under the *Penn Central* test, there is no occasion in this case to consider whether the nature or strength of the government's interests may properly be taken into account in applying the factors under that test—*e.g.*, in determining the "character of the governmental action" or the extent to which it interferes with "distinct investment-backed expectations." See 437 U.S. at 124. Cf. *Keystone Bituminous Coal Ass'n* v. *DeBenedictis*, 480 U.S. 470, 485-497 (1987) (discussing *Penn Central* factors in rejecting facial takings challenge to state-law restrictions on the mining of coal).

And, absent some reasonable basis for regarding Act 257 as analogous to an appropriation of property, neither the text and purposes of the Just Compensation Clause, nor the stated rationale for this Court's regulatory takings jurisprudence, supports the conclusion that the Act effects a taking.[9]

In another respect as well, the court of appeals' disposition of this case is in tension with established Just Compensation Clause principles. "The protection of private property in the Fifth Amendment presupposes that it is wanted for public use." *Mahon*, 260 U.S. at 415.[10] The Just Compensa-

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[9] For the reasons stated at pp. 17-21, *supra*, even economic regulation that is so patently inefficacious as to violate the Due Process Clause is not properly regarded as a "taking" of property. As a practical matter, the government's interests would be largely protected if truly irrational economic regulation were treated as both a due process violation *and* a taking, so long as the deferential "rational basis" standard applied to both sorts of constitutional claims. The decision whether to treat such regulatory measures as takings is not wholly without practical significance, however, in light of this Court's holding that the Fifth Amendment itself requires the payment of just compensation for a temporary regulatory taking. See *First English Evangelical Lutheran Church* v. *Los Angeles County*, 482 U.S. 304, 318-321 (1987). By contrast, nothing in the Constitution requires the government to provide monetary relief for victims of due process or equal protection violations. See *United States* v. *Hopkins*, 427 U.S. 123, 130 (1976).

[10] See U.S. Const. Amend. V ("[P]rivate property [shall not] be taken for public use, without just compensation."). Nonetheless, the Court has recognized that a particular exercise of the power of eminent domain "may not be successful in achieving its intended goals." *Hawaii Hous. Auth.* v. *Midkiff*, 467 U.S. 229, 242 (1984). The Court in *Midkiff* emphasized that "whether in fact the [government action] will accomplish its objectives is not the question: the constitutional requirement is satisfied if the state Legislature rationally could have believed that the [action] would promote its objective." *Ibid.* (citation, italics, brackets, and ellipses omitted); see *id.* at 242-243. Thus, the anomalous effect of the court of appeals' application of an independent "substantially advance" test for determining whether regulatory action constitutes a "taking" is to impose more rigorous judicial scrutiny under the Just Compensation Clause when the government does *not* exercise its eminent domain power than when it does. See Pet. App. 59-60. The same "public use" prerequisite to a lawful taking of property applies in the regulatory taking context as well, see

tion Clause thus "does not prohibit the taking of private property, but instead places a condition on the exercise of that power. * * * [I]t is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." *First English Evangelical Lutheran Church* v. *Los Angeles County*, 482 U.S. 304, 314-315 (1987). For that reason, "[e]quitable relief is not available to enjoin an alleged taking of private property for a public use, duly authorized by law, when a suit for compensation can be brought against the sovereign subsequent to the taking." *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1016 (1984) (footnote omitted).[11]

Notwithstanding those established principles, the courts below treated the determination that Act 257 effected a taking as a basis for declaring the Act to be unconstitutional and enjoining its enforcement. That disposition was certainly understandable: because the district court found that Act 257 would not substantially advance any public interest, and the court of appeals sustained that finding as not clearly erroneous, invalidation of the law plainly is a more apt remedy than a directive that money be paid from the public fisc. But the courts' perception that invalidation rather than compensation was the appropriate remedy itself

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Ruckelshaus v. *Monsanto Co.*, 467 U.S. 986, 1014 (1984), and indeed the "public use" requirement would be a proper basis under the Just Compensation Clause for any examination parallel to that under the Due Process Clause of whether the governmental action could rationally be expected to advance a legitimate public purpose.

[11] Injunctive or declaratory relief may be appropriate in takings cases if the practical availability of just compensation is doubtful, see *Duke Power Co.* v. *Carolina Envtl. Study Group, Inc.*, 438 U.S. 59, 71 n.15 (1978), or if the legislature has explicitly or by implication made a compensation remedy unavailable, see *Preseault* v. *ICC*, 494 U.S. 1, 12 (1990); *Eastern Enters.* v. *Apfel*, 524 U.S. 498, 520-521 (1998) (plurality opinion). But the court of appeals did not suggest that either of those circumstances is present in the instant case.

strongly suggests that respondent's constitutional challenge sounds in due process—or perhaps in the separate requirement in the Just Compensation Clause that any taking be for a "public use" (see note 10, *supra*)—and does not implicate the purposes of the Just Compensation Clause of identifying what governmental action does constitute a taking and ensuring the payment of compensation for it. After all, when a court concludes that a statute imposes constitutionally disproportionate burdens on affected property owners, just compensation from general revenues is a perfectly tailored remedy. When the court finds a law inefficacious, just compensation is a non sequitur.

D. This Court's Decisions Do Not Support The Court Of Appeals' Determination That Act 257 Should Be Reviewed Under A Standard More Demanding Than The Rational-Basis Standard

In *Agins* v. *City of Tiburon*, 447 U.S. 255, 260 (1980), this Court stated that "[t]he application of a general zoning law to particular property effects a taking if the ordinance does not substantially advance legitimate state interests, see *Nectow* v. *Cambridge*, 277 U.S. 183, 188 (1928), or denies an owner economically viable use of his land, see *Penn Cent. Transp. Co.* v. *City of New York*, 438 U.S. 104, 138 n.36 (1978)." In several decisions since *Agins*, this Court has quoted the "substantially advance" formulation in describing the bases on which a landowner may establish the existence of a compensable taking.[12] Taken as a whole, however, this Court's precedents do not support respondent's Fifth Amendment challenge to Act 257.

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[12] See *United States* v. *Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985); *Keystone Bituminous Coal Ass'n* v. *DeBenedictis*, 480 U.S. 470, 485 (1987); *Nollan*, 483 U.S. at 834 & n.3, 841; *Yee*, 503 U.S. at 534; *Lucas*, 505 U.S. at 1016; *Dolan*, 512 U.S. at 385; *City of Monterey* v. *Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 704 (1999); *Tahoe-Sierra*, 535 U.S. at 334.

1. Although this Court has frequently used the phrase "substantially advance" in describing the standards that govern regulatory takings cases, its references to that formulation generally have been brief, perfunctory, and either not seriously at issue or irrelevant to the ultimate disposition of the pertinent cases.[13] The Court has never found a taking based on doubt that an economic or land-use regulation would actually achieve its intended objective. Nor has the Court ever engaged in extended consideration of the efficacy of a challenged regulation in order to determine whether it worked a taking. The Court's prior statements that regulation may be deemed a taking if it does not "substantially advance" a legitimate government interest are therefore properly treated as dicta.[14]

2. As authority for the "substantially advance" standard, the Court in *Agins* cited *Nectow* v. *City of Cambridge*, 277 U.S. 183, 188 (1928); and the Court illustrated the application of the constitutional standard by discussing its "seminal decision" in *Village of Euclid* v. *Ambler Realty Co.*, 272 U.S. 365, 395 (1926) (*Euclid*). See *Agins*, 447 U.S. at 260, 261. The Court in *Nectow* stated that a restriction on private development adopted as part of a municipal zoning plan generally "cannot be imposed if it does not bear a substantial

[13] Of the cases cited in note 12, *supra*, *Nollan* and *Dolan* are the only two decisions in which the Court's takings analysis focused on the relationship between the relevant governmental objectives and the means used to attain those ends. Those cases, which involved distinct issues associated with exactions and permanent physical occupations of land (issues not presented here), are discussed at pp. 26-29, *infra*.

[14] In *Agins* itself, the Court concluded that the challenged zoning ordinances *did* "substantially advance legitimate governmental goals," 447 U.S. at 261, and it held that no taking had occurred, *id.* at 263. Significantly, however, the landowners in *Agins* did not contend that the challenged zoning restriction failed to advance a legitimate state interest. See Br. for Appellants at 17 n.5, *Agins*, *supra* (No. 79-602) ("[T]hat the City of Tiburon may take private property for public use, and that open space is one species of such legislatively declared public use, cannot be the subject of rational debate in the case at bench.").

relation to the public health, safety, morals, or general welfare." 277 U.S. at 188 (citing *Euclid*). The plaintiff in *Nectow* did not invoke the Just Compensation Clause, however, but instead contended that the zoning regime "deprived him of his property without due process of law in contravention of the Fourteenth Amendment." *Id.* at 185; accord *Euclid*, 272 U.S. at 384. In rejecting that claim, the *Nectow* Court observed that

> a court should not set aside the determination of public officers in such a matter unless it is clear that their action "has no foundation in reason and is a mere arbitrary or irrational exercise of power having no substantial relation to the public health, the public morals, the public safety or the public welfare in its proper sense."

Id. at 187-188 (quoting *Euclid*, 272 U.S. at 395).

Because the *Agins* Court relied on *Nectow* as authority for the "substantially advance" standard, and *Nectow* (like *Euclid*) used the phrase "substantial relation" in contradistinction to "a mere arbitrary or irrational exercise of power," *Agins* should not be read to have approved a means-ends inquiry under the Just Compensation Clause that is more demanding than rational-basis review. Read in its proper context, and considering the Court's reliance on *Nectow* and *Euclid*, the relevant sentence in *Agins* could be read to use the term "taking" in a generic sense that includes a "deprivation" of property in violation of the Due Process Clause. Cf., *e.g.*, *Rowan* v. *United States Post Office Dep't*, 397 U.S. 728, 740 (1970) (describing plaintiffs' constitutional challenge as a contention that the disputed regulatory action "violates the Fifth Amendment because it constitutes a taking without due process of law"). At most, the pertinent sentence in *Agins* simply suggests that, when land-use regulation is so clearly inefficacious as to constitute a violation of substan-

tive due process principles, it also effects a taking of property.[15]

That proposition should be rejected for the reasons stated at pages 16-21 & note 9, *supra*. Because a determination that particular regulation is ineffective has no bearing on whether its attendant burdens have been unduly concentrated on particular property owners, such a determination provides no basis for treating the regulation as the functional equivalent of an exercise of eminent domain. But even if wholly inefficacious economic or land-use regulation is deemed to be a taking as well as a due process violation, there is no warrant for the Ninth Circuit's decision to engage in a *more demanding* means-ends inquiry under the Just Compensation Clause than would be appropriate in a due process or equal protection case. See pp. 11-15, *supra*.

3. In *Nollan* v. *California Coastal Commission*, 483 U.S. 825 (1987), and *Dolan* v. *City of Tigard*, 512 U.S. 374 (1994), the Court addressed the distinct question of what standard governs when the grant of a development permit is made contingent on the permittee's willingness to cede a public right-of-way across his land. The Court held that such an exaction may be imposed without effecting a compensable taking if, but only if, "the required dedication is related both in nature and extent to the impact of the proposed development." *Id.* at 391. The Court explained in *Nollan* that the government may condition approval for development on exactions reasonably tailored to redress the problems (*e.g.*,

[15] The amicus brief for the United States in *Agins* stated (at 8) that "a land use regulation such as a zoning ordinance is not deemed a taking without just compensation under the Fifth Amendment where the regulation is not 'clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare' (*Euclid* v. *Ambler Realty Co.*, *supra*, 272 U.S. at 395) and does not deprive the owner of every reasonable beneficial use of his property." The brief further stated (at 15 n.6) that the inquiry into whether the ordinance would serve a legitimate public purpose "may also be regarded as a substantive economic due process test."

visual clutter or traffic congestion) that are caused by the development itself, but that the power to grant or withhold a permit may not legitimately be used as leverage to coerce an exaction that is intended to serve unrelated government interests. See *Nollan*, 483 U.S. at 837 ("[U]nless the permit condition serves the same governmental purpose as the development ban, the building restriction is not a valid regulation of land use but an out-and-out plan of extortion.") (citation and internal quotation marks omitted). The Court in *Dolan* further clarified that nexus requirement, framing the applicable standard as whether a "rough proportionality" exists between the required dedication of property and the anticipated impacts of the proposed development. See *Dolan*, 512 U.S. at 391. Although the Court made clear that "[n]o precise mathematical calculation is required," its analysis indicates that the "rough proportionality" standard is intended to be somewhat more demanding than rational-basis review under the Equal Protection Clause. See *ibid.*

Nollan and *Dolan* do not support the court of appeals' decision to apply heightened scrutiny in reviewing the rent restrictions imposed by Act 257. As the Court made clear in *City of Monterey*, *Dolan*'s "rough proportionality" standard is limited to "the special context of exactions," 526 U.S. at 702, and does not apply to regulatory takings claims generally, see *id.* at 703. The Court's concern in *Nollan* and *Dolan* was not that the challenged government conduct was unlikely to further any legitimate public interest. To the contrary, the challenged permit conditions appear to have been an efficacious—perhaps, too efficacious—means of achieving the relevant governmental objective. Rather, the issue in those cases was whether (and under what circumstances) a compelled dedication of an easement across real property—a permanent physical occupation that would have been a *per se* taking if imposed directly outside the permitting process—could nonetheless be imposed as a condition for a development permit. See *Nollan*, 483 U.S. at 834. Because the

governmental bodies in *Nollan* and *Dolan* sought to use the landowners' planned development activities to justify uncompensated exactions that would otherwise have violated the Constitution, the Court required a heightened showing, not simply that the permit conditions would advance *some* state interest, but that they would alleviate germane problems, *i.e.*, problems caused by the permitted development activities themselves.

The nexus requirement announced in *Nollan* and refined in *Dolan* is consistent with the legal rules that generally apply when a government benefit is conditioned on the recipient's willingness to forgo the exercise of a constitutional right. See *Dolan*, 512 U.S. at 385, 391 (invoking the "well-settled doctrine of 'unconstitutional conditions'" in support of the requirement that a meaningful nexus must exist between the required dedication and the impacts of the proposed development); see generally, *e.g.*, Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 Harv. L. Rev. 1415, 1458-1468 (1989) (when the provision of a government benefit is conditioned on the recipient's surrender of a constitutional right, the constitutionality of the condition depends substantially on whether the condition serves the same purpose as would an outright denial of the benefit); Robert L. Hale, *Unconstitutional Conditions and Constitutional Rights*, 35 Colum. L. Rev. 321, 350-352 (1935) (same). The purpose of that nexus requirement is not to protect the public against foolhardy or inefficacious economic regulation. Rather, the requirement is intended to prevent the government from coercing dedications of property through the use of permit conditions, thereby evading the duty to pay compensation that a permanent physical occupation of land would otherwise entail. See *Nollan*, 483 U.S. at 841 ("[W]here the actual conveyance of property is made a condition to the lifting of a land-use restriction, * * * there is heightened risk that the purpose is avoidance of the compensation requirement, rather than the stated police-power objective.").

The instant case does not implicate that concern, since Act 257 involves direct regulation of economic transactions between private parties and contains no mechanism by which the State can require dedication of private property to use by the public. There is nothing anomalous in recognizing that the government's attempt to acquire a public easement across real property without compensating the owner—a mode of land-use regulation that the Fifth Amendment would ordinarily forbid—is subject to closer judicial scrutiny than is the sort of rent-control legislation at issue here, which has long been treated as presumptively valid. See pp. 10-11, *supra*. And, to the extent that *Nollan* and *Dolan* may be ambiguous, they should be construed in a manner that avoids needless tension with the large body of precedent emphasizing the importance of judicial deference to legislative judgments in the economic sphere. See Frank Michelman, *Takings, 1987*, 88 Colum. L. Rev. 1600, 1608-1609 (1988) (To interpret *Nollan* as limited to government-imposed permanent occupations of property "fully explain[s] the opinion and its result without, implausibly, turning *Nollan* into *Lochner redivivus*.").

4. Finally, stare decisis considerations do not weigh solely or even primarily on respondent's side of this case. Disavowal of the "substantially advance" formulation as an independent standard for finding a taking would involve the repudiation of language in several of this Court's decisions. Rejection of those statements, however, would not cast doubt upon the *outcome* of any of the Court's prior cases; it would not undermine any genuine reliance interests; and it would be consistent with the broader principles of law, developed by this Court over a period of several decades, that govern constitutional challenges to economic legislation generally and regulatory takings claims in particular.

The legal standard articulated and applied by the court of appeals, by contrast, cannot be reconciled with established rules of legislative preeminence in the realm of economic affairs. Respondent's argument is also inconsistent with this Court's recognition that the distinguishing feature of a "regulatory taking" is that it subjects discrete property owners to disproportionate burdens analogous to those imposed by an exercise of eminent domain. The court of appeals departed substantially from those principles by treating the Just Compensation Clause as a ground for enjoining enforcement of Act 257, based on the purported inefficacy of the Act and without regard to any burdens it may have imposed upon respondent. This Court's endorsement of that approach would disrupt the existing legal regime far more significantly than would a repudiation of the "substantially advance" dicta.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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No. 04-163

In The
Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and MARK J. BENNETT, Attorney General of the State of Hawaii,

Petitioners,

v.

CHEVRON U.S.A., INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF ACTION APARTMENT ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether a state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo*, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

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INTEREST OF THE *AMICUS CURIAE*

In Southern California concerns over *Lochner*'s revival, 198 U.S. 45 (1905), seem prosaic.[1] With the region's housing, environmental and fiscal problems more and more intrusive land use regulations are a certainty. Southern California property owners rely on Federal Courts not to turn back the clock, but to help manage conflicting demands on the community's resources that will only increase in the future.

Amicus Curiae Action Apartment Association, Inc., is a nonprofit association of Santa Monica and Los Angeles housing providers subject to rent control. Action advocates for its members in legislative and political forums and in court, where it has successfully challenged enactments violative of constitutional rights. The *Substantially Advance* requirement has protected Action's members from border-line irrational property infringement harmful to them and the community. In *Action Apartment Ass'n, Inc. v. Santa Monica Rent Control Bd.*, 94 Cal. App. 4th 587 [114 Cal. Rptr. 2nd 412] (2001), discussed *infra*, the Court used the *Substantially Advance* requirement to overturn a rent control enactment it found lacked "logic, fairness or justice" and was "an unedifying example of class legislation." 94 Cal. App. 4th 604, 606.

Amicus is currently prosecuting a takings claim in U.S. District Court for the Central District of California, *Action Apartment Ass'n, Inc. v. Santa Monica Rent Control Board*, CV04-10343.

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[1] The parties have consented to *Amicus Curiae* filing this brief. Neither party nor their counsel authored the brief in whole or in part. No one other than the *Amicus Curiae* and its counsel made a monetary contribution for this brief's preparation and submission.

SUMMARY OF ARGUMENT

Because society receives no benefits to offset the property owner's injury, land use regulations that are not in the public interest are unconstitutionally unfair takings.[2] Hawaii enacted a rent control statute which harms the public, but since its legislature could have rationally concluded otherwise Hawaii claims the law is fair.

The issue before the Court is which branch of government determines what is an unconstitutionally unfair infringement on property rights, the judiciary or the legislature?

It would be contrary to precedent, logic, public policy and the text of the Fifth Amendment to defer to the legislatures' judgment of the constitutional fairness of laws they author. Takings doctrine grants the police power significant intrusions into Fifth Amendment private property rights, including rational basis deference to the legislature's determination of what constitutes a public use. Were the Court to permit rational basis review of constitutional fairness, the Just Compensation Clause would be completely coterminous with the police power. Rather than a delicate balance of public and private interests, private property would be subject to all but the most irrational and arbitrary state action. Property owners could be singled out to bear burdens properly borne by the public as a whole. This is not what the Fifth Amendment contemplates.[3]

Choosing public uses may be best accomplished in the legislature, but assessing constitutional fairness is a judicial function.[4] There is no evidence legislatures are

[2] *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 414-416 (1922).

[3] *Yee v. City of Escondido*, 503 U.S. 519, 522-523 (1992).

[4] *West Virginia State Bd. of Educ. v. Barnette*, 319 U.S. 624, 638 (1943).

more competent arbiters of fairness and much to the contrary. In California, where state courts apply rational basis review to means-end analysis, municipalities have set off in a race for the bottom, enacting ever more confiscatory regulations and singling out property owners to fund and establish special-interest groups. Takings doctrine has been a successful effort to accommodate private property and the public interest. The Ninth Circuit correctly applied that doctrine to rent control. Its judgment should be affirmed.

STATEMENT OF THE CASE

Because Hawaii is small and remote it has high gasoline prices, an average of $.30 per gallon higher than the mainland.[5] In 1997 the Hawaii Legislature determined that the high prices were harming the State's economy and consumers. Rather than reduce gasoline taxes, encourage investment or subsidize consumers, it attempted to lower retail gasoline prices by regulating gasoline station owners. Act 257 § 3(c) of the 1997 Hawaii State Legislature limited the maximum rent that oil companies can collect from dealers who lease company-owned stations. The Legislature found that reducing dealers' operating costs would encourage dealerships, increase competition and thereby indirectly lower retail prices.[6]

Respondent Chevron U.S.A., Inc., owns two petroleum refineries in Hawaii. It retails its refined products through a network of Chevron owned stations. Chevron purchases or leases station plots, constructs the stations, performs ordinary maintenance and pays property taxes. Rather than operate the stations, it leases them to local dealers. It

[5] *Chevron U.S.A., Inc. v. Cayetano*, 57 F. Supp. 2d 1003, 1009-1010, 1014 (D. Haw., 1998).

[6] *Id.* at 1010.

recoups its investment through monthly lease payments and profits from gasoline sales. Dealers are required to enter into a gasoline supply contract with Chevron, which unilaterally determines the wholesale prices it charges. Chevron has invested more than $58,000,000 in locally operated service stations in Hawaii.[7]

Chevron brought a 42 U.S.C.S. § 1983 claim against Hawaii's Attorney General and then Governor, since replaced as a party by current Governor Linda Lingle, hereinafter "Hawaii." Chevron asserted that Act 257 abridged its Fifth Amendment property rights because it did not substantially advance a legitimate state interest. Since Act 257 burdened their property, Chevron claimed it effected a taking.[8]

On cross-motions for Summary Judgement the parties stipulated that the Act's rent cap would increase the value of dealers' leaseholds, and that incumbent dealers would be able to sell their franchises and capture the premium.[9] Hawaii does not see premium capture as a problem. Rather than inhibiting dealers from realizing their profits, the Act's § 3d provides that nothing prevents them from doing so.[10] The Court granted Chevron summary judgment on two grounds. It held that because Act 257 lacked a mechanism preventing premium capture it failed to substantially advance the State's interest of lowering gasoline prices. Instead, it increased the price of leaseholds. Incumbent dealers could capture their premium by selling to new dealers, who would have no benefit to pass on to consumers. It further held that the Act's failure to

[7] *Chevron U.S.A., Inc. v. Cayetano*, 198 F. Supp. 2d 1182, 1185-1186 (D. Haw., 2002).

[8] *Chevron U.S.A., Inc. v. Cayetano*, 57 F. Supp. 2d at 1010.

[9] *Chevron U.S.A., Inc. v. Cayetano*, 224 F.3d 1030, 1033 (9th Cir., 2000) (*Chevron I*).

[10] *Chevron U.S.A., Inc. v. Cayetano*, 57 F. Supp. 2d at 1005.

prevent Chevron from raising wholesale gasoline prices to recoup lost rental income also rendered it ineffective.[11]

On appeal, Hawaii did not contest the District Court's finding that the Act was intended to reduce retail gasoline prices. Instead, it claimed that the correct standard of review was not whether the Act failed its goal, but whether the legislature "rationally could have believed the Act would substantially advance a legitimate government purpose."[12] It further argued that whatever the standard, material issues of fact remained and therefore summary judgment was inappropriate.

The Ninth Circuit reversed and remanded. It disagreed with Hawaii's contention that the State's rational belief in a substantial means-end relationship entitled it to enact any rent control law no matter how misguided. But it also found fault with the Court's analysis. Chevron's showing that the Act permitted premium capture and pass-through of rental losses to consumers did not meet plaintiff's burden under the *Substantially Advance* requirement. Chevron had to show that either premium capture or pass-through would occur, and occur to the extent that they would defeat the Act's goals.[13]

Upon remand Hawaii agreed that dealers would not pass rent savings on to consumers, and admitted that rents had nothing to do with high retail prices.[14] Instead, it presented evidence that lower rents would attract more dealers, stimulating competition and thereby indirectly lowering prices.[15]

[11] *Id.* at 1012-1014.

[12] *Chevron U.S.A., Inc. v. Cayetano*, 224 F.3d at 1033, n.3 (*Chevron I*).

[13] *Id.* at 1037-1038.

[14] *Chevron U.S.A., Inc. v. Cayetano*, 198 F. Supp. 2d 1182, 1190-1191.

[15] *Id.* at 1191.

Hawaii's theory was weak and did not prevail. The District Court found that Act 257 would raise gasoline prices and reduce competition. While incumbent dealers benefited from the Act, no one else did. The Act contained no incentives for dealers to lower retail prices. At the same time, Chevron had a great incentive to raise prices – to recoup lost rents – and its supply contracts gave it the power to do so. Moreover, the shortage of dealerships was not due to too few Hawaiians willing to operate them, but too few oil companies willing to finance them. Rent control would discourage, not encourage, oil company investment, and lead companies to raise prices and close marginally performing stations. It would make a bad situation worse.[16]

Hawaii again appealed, arguing that the (1) District Court applied the wrong standard, (2) granted it inadequate deference, and (3) reached an erroneous conclusion. Even dissenting Circuit Judge Fletcher conceded the evidence clearly proved that the Act did not substantially advance a legitimate purpose.[17] The Circuit held Hawaii's other two arguments barred by the law of the case. The Court granted Hawaii's Petition for a Writ of Certiorari.

ARGUMENT

1. The *Substantially Advance* requirement is firmly rooted in the Court's Just Compensation Clause jurisprudence.

A. The Just Compensation Clause protects private property from unfair takings.

"Nor shall private property be taken for public use, without just compensation." U.S. CONST., AMDT. 5. The aim of the Just Compensation Clause is to prevent the

[16] *Id.* at 1191-1192.

[17] *Chevron U.S.A., Inc. v. Lingle*, 363 F.3d 846, 859 (9th Cir., 2004) (J. Flectcher, dissenting).

government "from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

Takings problems arise from either physical invasion or public programs. Public programs, even well intentioned ones, may effect takings. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978). Allegations that they do – regulatory takings claims – present issues of whether economic legislation exceeds the bounds of fairness and justice. But whether one views the Fifth Amendment as a limitation on police powers, or police powers a limitation on property rights, neither engulfs the other:

> "The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides that it shall not be taken for such use without compensation. . . . When this seemingly absolute protection is found to be qualified by the police power, the natural tendency of human nature is to extend the qualification more and more until at last private property disappears. But that cannot be accomplished in this way under the Constitution of the United States. The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

In order to determine the bound of fairness and justice, and if the government has gone too far, the Court articulated a three-factor balancing test. The first two factors – the regulation's economic impact on the claimant and the extent to which it interferes with reasonable investment-backed expectations – focus on the property right infringement. The third – the character of the governmental action – focuses on the public benefit. *Penn Central Transp. Co. v. New York City*, 438 U.S. at 124. The test is an ad hoc, factual inquiry. *Id.*

A number of corollaries – the *Substantially Advance* requirement included – arise from the *Penn Central* formulation. Although these corollaries are commonly referred to as "exceptions" or "alternatives" to the *Penn Central* test, they are more precisely special applications of the test, applications where one factor tips the scales so strongly it is unnecessary to weigh the other two. For example, a regulation which denies property owners all economically viable use of their property is a taking without regard to the public benefit.[18] And under the *Nuisance Exception,* the government can employ its police power to prevent property owners from using their property to injure others without providing compensation.[19]

The *Substantially Advance* test uses the same logic as the *Nuisance Exception*, but it applies in opposite circumstances. Under the test, a regulation which limits land use but fails to substantially advance a legitimate state interest effects a taking.[20] In accord with the *Nuisance Exception,* parties pleading no substantial advancement are not required to establish the extent to which the challenged law affects property values. But instead of providing a defense for governments advancing urgent public interests, the *Substantially Advance* requirement helps plaintiffs avoid property infringement where the character of the public interest is so slight it cannot conceivably outweigh any right infringed.

B. The *Substantially Advance* requirement is an integral part of takings analysis.

While *Agins* articulated the *Substantially Advance* requirement's modern formulation, it neither invented it

[18] *Agins v. Tiburon*, 447 U.S. 255, 260 (1980).

[19] *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 512-513 (1987) (J. Rehnquist, dissenting).

[20] *Id.*

nor borrowed it from due process doctrine. The rule that a land use regulation which fails to substantially advance a state interest is unconstitutionally unjust had long been relied upon to overturn legislation.

In *Pennsylvania Coal v. Mahon*, the Mahons owned the surface estate underneath which the Pennsylvania Coal Company mined coal. The Mahons derived their title from the company, which had reserved the right to remove coal without liability from its activities. Despite the reservation, the Mahons sought an injunction preventing further mining beneath their premises under the Kohler Act of 1921. The Act prohibited mining that caused subsidence under structures on land where the surface and underground rights were owned by different parties.[21]

The Kohler Act was unfair and thus a taking. Because concurrent owners of both estates were allowed to extract coal without limitation, surface estate owners could acquire underground estates free of restrictions, and inflict harms the Act sought to prevent. The Act benefited surface owners, not the public. The coal company surrendered its mining rights under the pretext of subsidence prevention, but the Act failed to prevent subsidence, so it received nothing for its rights, no "average reciprocity of advantage."[22] Without reciprocity the Act was unconstitutionally unfair.

Pennsylvania Coal is the source of the modern *Substantially Advance* test.[23] Contrary to Hawaii's assertion,

[21] *Pennsylvania Coal Co. v. Mahon*, 260 U.S. at 412-413.

[22] *Id.* at 414-416. In addition to finding the Act unconstitutionally served purely private interests, Justice Holmes found that it denied the coal company any value for its rights. Both the denial of a viable use and the lack of a substantial advancement of a public purpose rendered the Act unconstitutional. *Id.* at 414.

[23] *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. at 484-485.

Agins's formulation was not dictum.[24] The *Agins* Court applied the test, finding that Plaintiffs challenging the City of Tiburon's zoning ordinances had no substantial advancement claim. Tiburon's zoning insured orderly development and open spaces, which Plaintiffs also enjoyed. The shared advantages meant the law was fair. *Agins v. Tiburon*, 447 U.S. at 262. *Agins* conducted the same review *Chevron I* required of the District Court, except here the District Court came down against the government. Since Act 257 hurts Hawaii's consumers and economy, Chevron receives no reciprocity for surrendering its property rights. The Ninth Circuit's holding that this effects a taking is in accord with long-standing Fifth Amendment doctrine.

Takings claims require a fairness evaluation, described variously as "proportionality," "cost spreading," "means-ends" or "reciprocity of advantage."[25] The *Penn Central* Court applied a "reasonably necessary to the effectuation of a substantial public purpose" standard.[26] Because Act 257 fails to substantially advance a legitimate state interest it is unfair under any of those formulations, and is a taking, without regard to whether it diminishes economic values or usefulness.

C. A fairness determination requires an analysis of the relationship between Act 257's means and ends.

Hawaii and *Amici* agree that fairness is the goal of takings analysis, but insist the Court determine fairness by looking exclusively at the impact upon Chevron, without taking into account Act 257's harm to Hawaii's

[24] Brief for Petitioners p. 25.

[25] *Santa Monica Beach, Ltd. v. Superior Court*, 19 Cal. 4th 952, 1025 [81 Cal. Rptr. 2nd 93] (1999) (Brown, J., dissenting).

[26] *Penn Central Transp. Co. v. New York City*, 438 U.S. at 127 (stating test), 129 (applying it).

consumers and economy.[27] This is not what *Penn Central* and *Pennsylvania Coal* require. Hawaii selectively quotes the decision in *Keystone Bituminous Coal Ass'n v. DeBenedictis* as stating "[t]hat a land use regulation may be somewhat overinclusive or underinclusive is, of course, no justification for rejecting it."[28] However, the Court immediately qualified this statement, and endorsed and applied the mean-ends inquiry:

> "But on the other hand, *Pennsylvania Coal* instructs courts to examine the operative provisions of a statute, not just its stated purpose, in assessing its true nature. In *Pennsylvania Coal*, that inquiry led the Court to reject the Pennsylvania Legislature's stated purpose for the statute, because the "extent of the public interest is shown by the statute to be limited." In this case, we, the Court of Appeals, and the District Court, have conducted the same type of inquiry the Court in *Pennsylvania Coal* conducted." *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 487 n.16 (citing to *Pennsylvania Coal v. Mahon*, 260 U.S., at 413-414).

In *Hodel v. Irving*, 481 U.S. 704 (1987), the Court found the Indian Land Consolidation Act of 1983 § 207 a taking after determining that the Act's operative provisions conflicted with its ends. In 1889 Congress allotted lands reserved for the Sioux Indian Nation to individual Sioux. To protect the Sioux from improvident disposition of their land the tracts were alienable by decent only. Succeeding Sioux generations divided their predecessors' tracts into increasingly tiny undivided fractional interests,

[27] Brief for Petitioners, p. 15 (urging the Court to "focus largely, if not exclusively" on the impact on claimant); p. 16 ("fairness and justice"); Brief for the United States as *Amicus Curiae*, p. 24 ("Nor has the Court ever engaged in extended consideration of the efficacy of a challenged statute"); p. 18 ("justice and fairness").

[28] Brief for Petitioners, p. 44.

which often yielded pennies in annual rent, and resulted in enormous administrative costs. Productive land was lying fallow due to the difficulties of managing property in this manner. Congress responded with the Indian Land Consolidation Act of 1983. The Act provided that any undivided fractional interest representing less than 2% of a tract's acreage, and earning less than $100 in the preceding year, would escheat to the tribe without compensation to the owner's estate. 481 U.S. 704, 707-708.

The Court analyzed the Act's impact on tract owners, finding these two *Penn Central* factors together favored constitutionality.[29] But the Act's operative provisions strongly and decisively weighed against it. Since the Act abolished decent and devise it prevented passage to heirs who already owned an undivided property interest. In so doing the Act's operation conflicted with its purpose – ownership consolidation. *Id.* at 717-718. The need for consolidation, and the net positive effect on the tribe, may have justified the government's destruction of some tract owners' rights to devise their interests. But by abolishing decent and devise even where a tract's passage to the heir might have resulted in land consolidation the Act went "too far." *Id.* at 718.

The Ninth Circuit, in requiring an analysis of whether Act 257 substantially advanced its intended purpose, was in accord with *Hodel v. Irving* and established takings doctrine. Takings analysis requires "essentially ad hoc, factual inquiries."[30] The Circuit's methodology was proper.

D. The *Substantially Advance* requirement ensures that property will be fairly regulated.

The Emergency Price Control Act of 1942 authorized mandatory rent reductions in parts of the country where

[29] *Hodel v. Irving*, 481 U.S. 704, 714-716.

[30] *Penn Central Transp. Co. v. New York City*, 438 U.S. at 124.

World War II related activities had increased housing costs. The Court found the Act consistent with the Fifth Amendment, holding that it justly asked property owners to share the burdens of war.[31] The Court today is not revisiting whether a few can avoid shared sacrifice, but deciding if a subset of rent control laws, laws that single out property owners while worsening the problems they are enacted to address, are constitutionally fair. In addressing the fairness inquiry, *Amicus* the United States insists that evidence that these laws fail their aims is "logically irrelevant," that only a plaintiff's immediate burden is germane. Indeed, the United States argues that more effective legislation would likely impose a greater financial burden on Chevron, which under the Solicitor General's conception of takings doctrine would render the Act, if anything, more unfair.[32]

The Act's ineffectiveness is highly relevant because the ills Hawaii purports to remedy justify its infringement of property rights.[33] Since Act 257 worsens those ills it would subject Chevron to ever more infringement. Requiring property owners to submit to wealth redistributions which give rise to further financial demands is quintessential unconstitutional unfairness.

The relationship between social ills and private property rights was described in *Munn v. Illinois*, 94 U.S. 113 (1877). Munn, the owner of a Chicago grain elevator, was convicted of charging rates higher than Illinois permitted. He claimed unconstitutional violation of his property rights. The Court disagreed. Illinois could use its police power to regulate Munn's elevator fees because the

[31] *Bowles v. Willingham*, 321 U.S. 503, 512-513, 519 (1944).

[32] Brief for the United States as *Amicus Curiae*, pp. 16-21.

[33] *Pennell v. San Jose*, 485 U.S. 1, 20-22 (1988) (Scallia, J., concurring and dissenting).

possible use of his property to the public detriment granted the State an interest:

> "[W]e find that when private property is affected with a public interest, it ceases to be *juris privati* only. . . . Property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, *and must submit to be controlled by the public for the common good,* to the extent of the interest he has thus created." *Munn v. Ill.*, 94 U.S. at 125-126. (citation and epsilons omitted, emphasis added).

When rent control fails to advance the "common good" the fairness nexus breaks down. Constitutional fairness is predicated on a cause-and-effect relationship between a regulated land use – e.g., high rents – and social ills. "Once such a connection is no longer required, however, there is no end to the social transformations that can be accomplished by so-called 'regulation,' at great expense to the democratic process." *Pennell v. San Jose*, 485 U.S. at 20-22.

Rent control that exacerbates social ills, such as Act 257, are uniquely pernicious. As the public need for remedial resources is fueled by counterproductive legislative mandates, property owners affected with a public interest will incur ever greater regulatory demands. There is no natural stopping point, "no end" to the incremental confiscation or festering harm to society. Without a means-ends requirement the state's police power is free to swallow Fifth Amendment property rights.

Justice Holmes warned that property can be regulated until it disappears.[34] The *Substantially Advance* requirement insures that it is not.

2. The fairness inquiry requires intermediate scrutiny because legislatures are incompetent to determine fairness.

A. Rational basis review would take the *Just* out of the *Just Compensation* Clause.

The Court has been solicitous of the police power in fashioning takings doctrine. Unlike other enumerated rights, the police power is not required to yield to the Fifth Amendment. Instead, the Court accommodates public needs and private property rights through a give-and-take that allows public interests and private property to harmoniously coexist. Hawaii's requests would disrupt that balance.

The Court has frequently held that urgent public needs are secondary to enumerated rights even in economic contexts. In *Turner Broadcasting System v. FCC*, 512 U.S. 662 (1994) (*Turner I*), the Court refused to accept Congress's findings that local television broadcasters' economic viability was at risk and the must-carry provision of the Cable Act of 1992, requiring cable providers to carry local stations, a necessary cure. It held that First Amendment protections demanded greater scrutiny, and remanded for further factual findings. 512 U.S. at 666-669. In *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557 (1980), the Court found an order prohibiting advertising encouraging electricity consumption during a fuel shortage violated the First Amendment, despite finding that the order directly advanced a substantial state interest. 447 U.S. at 568-572.

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[34] *Pennsylvania Coal Co. v. Mahon*, 260 U.S. at 415.

The Court has also held that the Fourth Amendment trumps the police power, even where employed in purely economic legislation. In *Marshall v. Barlow's, Inc.*, 436 U.S. 307 (1978) it held that the Occupational Safety and Health Act of 1970 § 8(a), which empowered the Secretary of Labor to inspect facilities within its jurisdiction for safety hazards, violated the Constitution. Even businesses in closely regulated industries are protected from warrantless searches. 436 U.S. 314-315.

By contrast, takings doctrine has granted the police power significant intrusions into the Fifth Amendment. Primary among these is acquiescence to the legislatures' determination of what constitutes a *public use*. For this reason pre-1937 takings decisions survived the post-*Lochner* revolution intact. Justice Holmes described this high level of deference in *Pennsylvania Coal,* where he wrote:

> "We assume, of course, that the statute was passed upon the conviction that an exigency existed that would warrant it, and we assume that an exigency exists that would warrant the exercise of eminent domain."[35]

Legislatures alone decide what constitutes a *public use* to be advanced by exercise of the takings power.[36] Accordingly, the *public use* requirement is coterminous with the scope of sovereign police powers.[37] Deference to the legislature's *public use* determination is conditioned only by rational basis review.[38]

A plaintiff challenging governmental action as a taking also bears burdens of proof and production.[39] As

[35] *Pennsylvania Coal Co. v. Mahon*, 260 U.S. at 416.

[36] *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 244 (1984).

[37] *Id.* at 240.

[38] *Id.* (citing to *Old Dominion Co. v. United States*, 269 U.S. 55, 66 (1925)).

[39] *E. Enters. v. Apfel*, 524 U.S. 498, 523 (1998) (plurality opinion).

Justice Holmes noted, courts "assume the exigency exists."[40] In *Chevron I,* the Court held that Chevron had initially not met this burden. On remand, Chevron had to prove by a preponderance of the evidence that the Act did not substantially advance a legitimate state interest.[41] In accommodating the police power the Court has stripped the Just Compensation Clause of all but the fairness requirement. Rational basis review of fairness would improperly delegate the fairness inquiry to the legislatures. Choosing public uses may be better accomplished by legislators, but assessing constitutionally mandated fairness is a judicial function.[42]

Were the Court to delegate this judicial task to the legislature, the Just Compensation Clause would no longer be an independent source of any right except to an accurate accounting. It would become completely coterminous with the police power. Rather than a delicate balance of public and private interests, private property would be subject to all but the most irrational or arbitrary state action. Property owners could be singled out to bear burdens properly borne by the public as a whole. This is not what the Fifth Amendment contemplates.[43]

Requiring courts to assume state action "just" would negate the text of the Fifth Amendment. Federal courts already assume state interference with property is well intentioned, and they assume the state acted upon evidence that its interference was warranted. If the Just Compensation Clause is to remain a discrete source of

[40] *Pennsylvania Coal Co. v. Mahon*, 260 U.S. at 416.

[41] *Chevron U.S.A., Inc. v. Cayetano*, 224 F.3d at 1037 (*Chevron I*).

[42] *West Virginia State Bd. of Educ. v. Barnette*, 319 U.S. 624, 638 (1943); *see also Marbury v. Madison*, 5 U.S. 137, 177-180 (1803) (the "constitution must be looked into by the judges.").

[43] *Yee v. City of Escondido*, 503 U.S. 519, 522-523.

rights, heightened scrutiny of the remaining determination is necessary. In accord with takings doctrine's factual emphasis, the scrutiny level should relate to the character of the government action. In the rent control context, the *Chevron I* Court held that the *Substantially Advance* test required a determination of whether plaintiff had proved the absence of a "reasonable relationship" between the public purpose and the means employed, a standard more stringent than rational basis but less exacting than "rough proportionality."[44] This standard of review correctly applies the Court's accommodation of public and private rights to rent control. The Court should leave it undisturbed.

3. The *Substantially Advance* requirement is a necessary counterpart to the *Williamson* state-remedy exhaustion requirements.

The *Substantially Advance* requirement provides an alternative for Plaintiffs where state remedial procedures are futile in any but the most technical sense. *Yee v. City of Escondido* held that takings claims predicated on the *Substantially Advance* requirement are *per se* ripe. Allegations that a challenged regulation fails to advance a legitimate interest do not depend on the extent to which plaintiffs are deprived of use of their property or the inadequacy of their compensation. 503 U.S. 519, 534. Therefore the availability of alternative remedies is irrelevant.

The *Substantially Advance* requirement prevents municipalities from successfully enforcing legislation enacted to serve purely private interests by hiding behind California's high level of judicial deference and *Williamson*. It helps provide deserving civil rights plaintiffs their

[44] *Chevron U.S.A., Inc. v. Lingle*, 363 F.3d 846, 853-854.

day in Federal Court. Rather than contradicting *Williamson*, the requirement assures its coherence.

In *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985), plaintiff's predecessor received County approval to develop its property. It then conveyed to the County an easement and began building roads, utility lines and a golf course. The County later changed its zoning ordinance and ruled the development nonconforming. A U.S. District Court found that the County's refusal to grant final approval violated the Just Compensation Clause. 473 U.S. 172, 178-182. The County appealed.

This Court held the claim unripe. Under applicable state law Plaintiff could have brought an inverse condemnation action to obtain just compensation. But it had not, nor had it alleged inverse condemnation was unavailable or inadequate. Moreover, Plaintiff had failed to apply for a variance. Since either procedure may have provided a remedy Plaintiff was not conclusively denied just compensation. Its taking action was premature. *Id.* at 196-197, 200.

California's disregard for private property rights has encouraged municipalities to abuse the *Williamson* requirements. As the Court has noted, California is alone among the fifty States in its acceptance of private property infringement.[45] In addition to evaluating takings claims under the deferential due process standard,[46] California requires victims of unconstitutional rent control to seek an adjustment of prospective rents as a remedy.[47] Plaintiff has

[45] *Nollan v. California Coastal Com.*, 483 U.S. 825, 839 (1987).

[46] *Galland v. City of Clovis*, 24 Cal. 4th 1003, 1024 [103 Cal. Rptr. 2nd 711] (2001).

[47] *Id.* at 1022.

the burden of showing that this untested procedure is inadequate or unavailable.[48]

Municipalities have successfully taken advantage of these impediments. In *Galland v. City of Clovis,* Clovis and its rent commission violated Galland's due process rights by "making the rent review process so time consuming, burdensome and expensive that the potential benefits of participating in the process were nonexistent and illusory."[49] Nevertheless, the California Supreme Court overturned much of Galland's 42 U.S.C.S. § 1983 award. Although Galland brought a substantive due process claim, the Court said it was indistinguishable from a takings action. Therefore Galland was not entitled to relief where they failed to seek a prospective rent adjustment from Clovis's unconstitutional rent review apparatus.[50] Also, damages could be recovered only through future rent adjustments – again by resort to Clovis's unconstitutional administrative procedures.[51]

California's hostility to takings claims and its inadequate alternative procedures are relevant to the issues before the Court because of the Federal judiciary's strict adherence to *Williamson*. Numerous Ninth Circuit Courts and plaintiffs have noted the difficulties California property owners have enforcing their rights.[52] But to prove futility under *Williamson*, Federal plaintiffs must show

[48] *Id.* at 1029-1030, n.5 (finding claims that prospective adjustment mechanism was inadequate "speculative").

[49] *Id.* at 1045 n.3 (J. Jones, dissenting).

[50] *Id.* at 1024-1025.

[51] *Id.* at 1046-1047, 1052-1054 (J. Brown, dissenting (citing Carroll, ALICE'S ADVENTURES IN WONDERLAND (1985 ed.) p. 115.)).

[52] *Carson Harbor Vill., Ltd. v. City of Carson*, 353 F.3d 824, 828, 830 (9th Cir., 2004); *Schnuck v. Santa Monica*, 935 F.2d 171, 173 (9th Cir., 1991); *Sinaloa Lake Owners Ass'n v. Simi Valley*, 882 F.2d 1398, 1403 (9th Cir., 1989).

they cannot "obtain just compensation through an inverse condemnation action under any circumstances."[53] It is impossible to make this showing in California because inverse condemnation recovery is technically feasible and administrative remedies technically available.

Hawaii and *Amici* mischaracterize the *Substantially Advance* test's important role when they complain that the Ninth Circuit uses it as an unconstitutional end-run around the *Williamson* state-remedy exhaustion requirements.[54] It is not. The test compliments *Williamson*, and the frequency with which it comes into play in Ninth Circuit jurisprudence reflects the unique circumstances in the Circuit.

4. Land use regulations which fail to substantially advance legitimate interests corrupt local government and increase economic inequity.

A. Welfare for the wealthy.

The poor, the elderly, single-parent families and other vulnerable members of society are all injured by unfair rent control. Act 257 raises costs to gas station owners but contains no mechanism to prevent owners from passing on their higher costs to consumers. As owners do this, by raising wholesale gasoline prices, the poor, for whom gasoline expenses are a relatively higher percentage of income, subsidize Hawaii's gas station operators, the Act's beneficiary.[55] Act 257 redistributes wealth, not from the wealthy to the needy, but from the underprivileged to the middle class. As social policy Act 257 is horrible. But as a

[53] *Schnuck v. Santa Monica*, 935 F.2d at 173-174.

[54] Brief for Petitioners, n.7, n.10; Brief of the League of California Cities as *Amicus Curiae*, pp. 12-13. (claiming that the Ninth Circuit contradicts and defies *Williamson County*).

[55] *Chevron U.S.A., Inc. v. Cayetano*, 224 F.3d at 1048 (J. Fletcher, concurring) (noting Chevron will likely offset lower rental revenues buy raising gasoline prices).

political tool it has its advantages. The poor don't vote as reliably and the middle class is the largest special interest group.[56]

Rent control is often designed to serve special interests at the expense of the less fortunate. In *Chicago Bd. of Realtors, Inc. v. Chicago,* 819 F.2d 732 (7th Cir., 1987), the Seventh Circuit examined a Chicago ordinance that prevented housing providers from passing on increased costs, permitted tenants to withhold rent for alleged lease violations and repairs, limited late fees, required security deposits to be held in local banks and otherwise granted tenants more rights.[57] Like Act 257, it promised relief for the needy. Like Act 257, it delivered subsidies for the well off and votes for incumbent politicians:

> "The ordinance is not in the interest of poor people. As is frequently the case with legislation ostensibly designed to promote the welfare of the poor, the principal beneficiaries will be middle-class people. They will be people who buy rather than rent housing (the conversion of rental to owner housing will reduce the price of the latter by increasing its supply); people willing to pay a higher rental for better-quality housing; and (a largely overlapping group) more affluent tenants, who will become more attractive to landlords because such tenants are less likely to be late with the rent or to abuse the right of withholding rent-a right that is more attractive, the poorer the tenant. The losers from the ordinance will be some landlords, some out-of-state banks, the poorest class of tenants, and future tenants. The landlords are few in number (once owner-occupied rental housing is excluded-and

[56] *Chicago Bd. of Realtors, Inc. v. Chicago*, 819 F.2d 732, 742 (7th Cir. 1987) (J. Posner, concurring).

[57] *Id.* at 741.

> the ordinance excludes it). Out-of-staters can't vote in Chicago elections. Poor people in our society don't vote as often as the affluent. And future tenants are a diffuse and largely unknown class. In contrast, the beneficiaries of the ordinance are the most influential group in the city's population. So the politics of the ordinance are plain enough, and they have nothing to do with either improving the allocation of resources to housing or bringing about a more equal distribution of income and wealth." 819 F.2d 732, 742 (1987) (J. Posner, concurring) (citations omitted).

When Judge Posner wrote this opinion in 1987 it was an emperor-has-no-clothes moment, cited in law school case books for years to come.[58] In 2005 it is anodyne. Now, harsher analyses can be heard from rent control's supporters. Judge Fletcher, the dissenting judge in *Chevron II*, conceded in his *Chevron I* concurring opinion that Act 257 was not in the interests of the underprivileged. He admitted that it was a subsidy for those who did not need any, and likely to harm public policy. Nevertheless, he disagreed with the Court's decision to remand with instructions to apply the *Substantially Advance* test.[59]

Judge Fletcher's point is that "we should not confuse inefficiency and unfairness with unconstitutionality."[60] Judge Fletcher would be wrong in most of the nation, where *Pennsylvania Coal* is the law and plaintiffs have the opportunity to prove that a statute fails to advance its ends before it is allowed to infringe their property rights. In those states unfairness is unconstitutionality. But not

[58] DUKEMINIER & KRIER, PROPERTY, pp. 535-537 (Fourth Ed. 1998).

[59] *Chevron U.S.A., Inc. v. Cayetano*, 224 F.3d at 1048 (*Chevron I*) (J. Fletcher, concurring).

[60] *Chevron U.S.A., Inc. v. Lingle*, 363 F.3d at 861 (*Chevron II*) (J. Fletcher, dissenting).

in California, where state courts rely on local politicians to conduct means-ends analyses and administrative remedies can be more road block than relief. Here *Pennsylvania Coal* and reciprocity of advantage are ignored.

B. Rational basis review of property rights results in a race for the bottom.

The dire public policy consequences of deferential review of Fifth Amendment property rights are apparent in Southern California. In *Santa Monica Beach, Ltd. v. Superior Court*, 19 Cal. 4th 952 (1999), the California Supreme Court examined a takings claim alleging that Santa Monica's housing rent control failed to substantially advance a legitimate public interest. The purpose of Santa Monica's Rent Control Charter Amendment, enacted in 1979, is to help tenants, "especially the poor, minorities, students, young families and senior citizens." 19 Cal. 4th 952, 957. Following the Charter Amendment's passage, the affluent found Santa Monica a more attractive domicile: the number of very-high income households increased 37% during 1980-1990, while the number of similar households in surrounding Los Angeles County dropped 8%. *Id.* at 957-958. But in providing affordable housing to its targeted groups Santa Monica's rent control has been an abject failure:

> "During the rent-controlled decade of the 1980's, Santa Monica experienced a loss of 775 low-income-renter households, a decrease of nearly 12 percent. The number of low-income-renter households increased over this period in every comparable city in Southern California without rent control. Santa Monica also lost 285 very-low-income-renter households. This was the largest decrease in the number of very-low-income renters of any comparable Southern California city."

> "Under rent control, housing in Santa Monica has become increasingly unavailable to young families. Between 1980 and 1990, the number of family households with children in Santa Monica fell by 1,299, a decline of more than 6 percent. No comparable city in Southern California without rent control lost family households over the decade of the 1980's.
>
> "The impact of rent control has been especially harsh on young families headed by a mother with no spouse. The number of female-headed households with children under the age of 18 in Santa Monica fell by 593 between 1980 and 1990, a decrease of more than 27 percent, despite an increase in such households in Los Angeles County as a whole.
>
> "Under rent control, Santa Monica's elderly population (age 65 or over) declined by 1.7 percent between 1980 and 1990, whereas the elderly population of Los Angeles County rose by more than 15 percent over the same decade." 19 Cal. 4th at 957-958.

On these facts, under rational basis review, the California Supreme Court held plaintiff had failed to state a *Substantially Advance* claim. The Court commented "we leave to legislative bodies rather than the courts to evaluate whether the legislation has fallen so far short of its goals as to warrant repeal or amendment." *Id.* at 957, 974. Repeal is improbable, and the Court's reliance on it improper. Santa Monica's growing percentage of high-income households are unlikely to give back their subsidies. Moreover, the purpose of the Bill of Rights is to withdraw certain subjects from political controversy, to place them beyond the reach of majorities and officials, and to establish them as legal principles to be applied by the courts, not legislatures. Property rights do not depend on the outcome of elections. *West Virginia State Bd. of Educ. v. Barnette*, 319 U.S. 624, 638 (1943).

California's disregard for the Fifth Amendment has set local officials off in a race for the bottom. In *Action Apartment Ass'n, Inc. v. Santa Monica Rent Control Bd.*, 94 Cal. App. 4th 587 [114 Cal. Rptr. 2nd 412] (2001), *Amicus* Action Apartment Association, Inc., challenged a 1999 decision of the same Santa Monica Rent Control Board and a section of its Charter on the grounds that they failed to advance a legitimate interest and effected a taking. Santa Monica had amended its Charter to require housing providers to place security deposits in a federally insured bank and pay tenants 3% interest per annum, irrespective of the bank rate earned by the housing providers. As the amendment was enacted, the Rent Control Board directed that the interest be paid to tenants. Previously, interest could be used to improve the property. At the time, federally insured banks paid between 0.5% and 1.5% per annum. These changes cost Santa Monica housing providers $770,000 annually.[61]

The Court of Appeal found that the Rent Control Board's actions forced housing providers into becoming the tenants' "cash cows." It failed to see how this advanced the Board's goals of improving housing conditions, the general welfare, or indeed any legitimate interest.[62] Instead, it found the Rent Board was attempting to transfer wealth from housing providers to tenants. This lacked "logic, fairness or justice." *Id.* at 604. The amendment was a taking, and "an unedifying example of class legislation." *Id.* at 606 (citing to *Chicago Bd. of Realtors, Inc. v. City of Chicago*, 819 F.2d at 741-742).

While much is opaque about unfair rent control laws, this much is not: lowering the standard of review from *de novo* to rational basis will change the trend in rent control

[61] *Action Apartment Ass'n, Inc. v. Santa Monica Rent Control Bd.*, 94 Cal. App. 4th at 595-596.

[62] *Id.* at 604-607.

enactments from bordering on unfair to bordering on the irrational. That cannot be positive for public policy.

C. Unconstitutional rent control funds special interests at great social cost.

The Ninth Circuit found a rent control ordinance similar to Act 257 a taking in *Richardson v. City & County of Honolulu*, 124 F.3d 1150 (9th Cir., 1997). The *Richardson* ordinance and Act 257 both harm the public, as did the ordinance overturned in *Action Apartment Ass'n, Inc. v. Santa Monica Rent Control Bd.* But while the *Action* ordinance was intended to transfer wealth to favored constituencies, Act 257 and the *Richardson* ordinance not only serve special interests, they create them.

Richardson v. City & County of Honolulu examined a rent control statute intended to provide affordable owner-occupied housing in Oahu. In Oahu, a small number of private owners control almost all nonpublic lands. Rather than sell, they typically long-term lease to builders. The builders construct condominiums, and residents who purchase from the builders are assigned their unit's ground lease. When the lease is up, the condominium owner and the land owner reset the lease rate, normally at a percentage of the fair market value of the land appurtenant to the unit exclusive of improvements. The rapid rise in Hawaiian land prices and the leases' long terms often result in renegotiated rents many times greater than the initial rent. 124 F.3d 1150, 1163.

To control escalating housing costs, the City and County of Honolulu enacted Ordinance 91-96. The Ordinance limits the number and regulates the timing of renegotiations. It also caps rents by linking the maximum renegotiated rent to the consumer price index, far lower than Hawaiian realty's appreciation rate. It further provides that if a condominium owner-occupant sells their ground lease during a renegotiated rent period to a prospective occupant, the renegotiated land rent applies to

the transferee. In other words, should an owner convey their lease to a person intending to occupy the condominium the transferee receives the benefit of the renegotiated lease. *Id.* at 1163-1164. The District Court found that incumbent sellers would receive a premium equal to the value of the benefit. The City and County did not appeal its finding.[63]

The Ninth Circuit struck down Ordinance 91-96 using the *Substantially Advance* test and intermediate scrutiny. Incumbent owners' ability to capture the net present value of the reduced rent in a premium meant that the Ordinance would not create affordable owner-occupied housing. Instead, the Ordinance would result in a one-time wealth transfer from land owners to current lessees. Condominium prices would increase by the value of future rent savings. Housing affordablity would remain unchanged, and the Ordinance would fail to advance its purpose. Therefore it effected a taking. *Id.* at 1166.

Why would legislatures include a premium capture provision in a rent control ordinance? In *Yee v. City of Escondido,* the Court suggested including such a feature in rent control legislation could render it a regulatory taking. 503 U.S. 519, 530. Act 257's drafters knew they were courting constitutional infirmity, yet the provision was irresistible nonetheless. It often is. *Richardson*, citing *Yee*, found its Hawaiian rent control ordinance unconstitutional on exactly this basis.[64] Constitutional niceties aside, and more to the point, these provisions defeat the legislature's stated purposes.

Legislators include self-defeating provisions because they are more concerned with reelection than constitutional rights, affordable housing or consumers. A premium capture provision not only favors special interests, it

[63] *Chevron U.S.A., Inc. v. Cayetano*, 224 F.3d at 1040 (*Chevron I*).

[64] *Richardson v. City & County of Honolulu* 124 F.3d at 1165-1166.

creates them. But for intermediate scrutiny, Oahu condominium owners would depend on their local rent board to maintain the value of their premiums. The capture provision is a valuable incentive to vote for the incumbents. Unlike adjustments that expire when the occupant moves, a beneficiary of premium capture has a tangible and possibly permeant wealth increase, one that can be realized immediately with a call to their bank.

For legislators and rent boards a premium capture provision is the gift that keeps giving. They obtain a new constituent with every resale. But to resale purchasers rent control brings only downside. They lack any transferred wealth, suffer higher up-front housing prices, and are dependant on rent boards to maintain the value of their investment. Voter ratification of these provisions fails to grant them constitutionality, contrary to *Amicus* supporting Hawaii.[65] A constitutional right can hardly be infringed simply because a majority of the people choose it to be. The fact that a challenged law was approved by the electorate is "without federal constitutional significance."[66]

Amicus Action Apartment Association respectfully requests that the Court consider the startling sight of elected officials of States from Massachusetts to Utah, representing the full panoply of American political diversity, united as *Amici* favoring legislation which harms the public. Here the Mayor of Berkeley, a member of *Amicus* League of California Cities, and the Solicitor General have found common cause, in support of laws without legitimate purpose. No consumer advocates urge the Court to uphold Act 257 – supposedly enacted in their interest – but politicians across the spectrum do. These laws are more

[65] Brief of the League of California cities as *Amicus Curiae*, p. 8.

[66] *Lucas v. Forty-Fourth General Assembly*, 377 U.S. 713, 736-737 (1964).

than just welfare for the wealthy. They are welfare for the political class, at great harm to public policy.

CONCLUSION

If the Court is to continue to defer to the legislature's *public use* determination, heightened scrutiny for fairness is appropriate. Without it, the Just Compensation Clause provides no justice, only a right to an accurate accounting. Since *Pennsylvania Coal* the Court has held that private property is constitutionally entitled to more.

In accord with takings doctrine's factual emphasis, the level of scrutiny should depend on the facts. Where the government uses its eminent domain power to transfer property between private citizens, the Constitution requires the transfer to be reasonably necessary.[67] Where it exacts property as a condition for land use, the nature and extent of the exaction must be proportional to the permitted development.[68] And where it limits property owners' rental rights, it may do so only if its legislation reasonably relates to the public interest.[69] Act 257 does not. The judgment of the Ninth Circuit should be affirmed.

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[67] *Kelo v. City of New London*, 843 A. 2d 500, 587-592 (2004 Conn.) (Zarella, J., dissenting).

[68] *Dolan v. City of Tigard*, 512 U.S. 374, 391 (1994).

[69] *Chevron U.S.A., Inc. v. Lingle*, 363 F.3d 846, 853-854.

(23)

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In The

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LINDA LINGLE, Governor of Hawaii, et al.,

Petitioners,

v.

CHEVRON U.S.A. INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF THE AMERICAN PLANNING ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining de novo, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

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INTEREST OF *AMICUS CURIAE*[1]

The American Planning Association is a nonprofit public interest and research organization, founded in 1978 exclusively for charitable, educational, literary, and scientific research purposes to advance the art and science of planning – physical, economic and social – at the local, regional, state, and national levels. APA's mission is to encourage planning that will contribute to public well-being by developing communities and environments that more effectively meet the present and future needs of people and society.

APA resulted from a merger between the American Institute of Planners, founded in 1917, and the American Society of Planning Officials, established in 1934. The organization has 46 regional chapters and 19 divisions devoted to specialized planning interests. APA represents more than 34,000 practicing planners, officials, and citizens involved with urban and rural planning issues. Sixty-five percent of APA's members work for state and local government agencies. These members are involved, on a day-to-day basis with the public, in formulating planning policies and preparing land-use regulations.

The American Planning Association has filed *Amicus* briefs in a number of cases involving the Takings Clause: *Agins v. City of Tiburon*, 447 U.S. 255 (1980); *Williamson County Regional Planning Com'n v. Hamilton Bank of Johnson City*, 473 U.S. 172 (1985); *First English Evangelical*

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[1] Counsel for the parties did not author this brief in whole or in part. No person or entity other than the *amicus*, its members, and its counsel made a monetary contribution to the preparation or submission of this brief. The parties have consented to the filing of *amicus* briefs.

Lutheran Church of Glendale v. Los Angeles County, 482 U.S. 304 (1987); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Suitum v. Tahoe Regional Planning Agency*, 520 U.S. 725 (1997); *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001); and *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302 (2002).

This case raises critical issues of national importance for state and local governments, and planners who work both in the public and private sectors, as well as the general public they serve.

SUMMARY OF ARGUMENT

Courts should not substitute their views of the wisdom or efficiency of state economic legislation under the guise of the Takings Clause.

The Takings Clause conveys a straightforward message: when government physically takes property, it must pay. Yet, no property of Respondent was physically taken by the statute.

Regulations that destroy all economic value of property also may fall within the compensation command of the Takings Clause based on the principle that such a denial is the functional equivalent of a confiscation. Yet, the statute did not deprive Respondent's property of economically viable use.

Principle does not support moving the Fourteenth Amendment's substantially advances test into the Takings Clause of the Fifth Amendment. The question of the

validity of government action is not a part of the takings inquiry, and it ought not become so based on the historical confusion between due process and takings.

The adoption of legislation, particularly at the local government level, aided by the planning process, involves the participation of all segments of the community working to define the public interest. Allowing judges to second guess legislation will undermine the public's role in the democratic process. Intermediate judicial scrutiny is neither needed nor justified to protect those who are well represented in legislative halls.

ARGUMENT

I. Whether legislation substantially advances a legitimate state interest is not a question within the purview of the Takings Clause.

A. Neither the language nor the purpose of the Takings Clause supports the use of the substantially advances test.

The Ninth Circuit's decision invalidating Hawaii's statute on the grounds that it represents unwise and ineffective legislation is wrongly based on the Takings Clause of the Fifth Amendment. The Takings Clause – "nor shall property be taken for a public use without just compensation" – on its face limits the eminent domain power, not the police power. The Court has subjected the police power to the Takings Clause, but only in cases where regulations have an economic impact that is tantamount to a confiscation of property. Except insofar as the exercise of the power of eminent domain must be for a public use, ill-advised governmental action is not within

the purview the Takings Clause. As Chief Justice Rehnquist has said:

> This basic understanding of the [Fifth] Amendment makes clear that it is designed not to limit the governmental interference with property rights per se, but rather to secure compensation in the event of an otherwise proper interference amounting to a taking.

First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 482 U.S. 304, 314-315 (1987).

The substantially advances test, drawn from *Agins v. City of Tiburon*, 447 U.S. 255 (1980), and used by the Ninth Circuit in the case at bar, assesses the validity of government action pursuant to the police power. This question, however, precedes the takings question. If a court finds a regulation does not substantially advance a legitimate state interest, the case is over and the regulation is invalidated. If a court finds the law does substantially advance a legitimate state interest, then the court may move to the question of whether that law has gone too far in the imposition of economic harm on a property owner and thus been converted into a taking. The substantially advances test, already answered, should not be reexamined as part of the takings inquiry.

The plain language of the Takings Clause cannot support a requirement that a law substantially advance a legitimate state interest. The mandate is straightforward. If government takes property for a public use, it must pay. While deciding what constitutes a "taking" or a "public use" or qualifies as "property" or suffices as "just compensation" may be difficult, they are questions that must be asked. What is not covered, and no reading, however

tortured, can supply it, is whether the government is doing a good job in legislating to promote the general welfare.

While the Court "has ... not read [the Takings Clause] literally," *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 142 (1978) (Rehnquist, J., dissenting), it has gone beyond the language of the Amendment to transmute regulations into takings in only the narrow circumstance where a regulation is the functional equivalent of a confiscation. Thus, while the operative language of the clause connotes a physical invasion or seizure, under *Pennsylvania Coal v. Mahon*, 260 U.S. 393 (1922), an otherwise valid regulation can be converted into a taking if it goes "too far." *Id.* at 415. In language perhaps more familiar to the law, such a regulation constitutes a "constructive taking" based on the reasoning that a "total deprivation of beneficial use is, from the landowner's point of view, the equivalent of a physical appropriation." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1017 (1992).

In contrast to the *Agins* supposed substantially advances takings test, *Pennsylvania Coal's* regulatory takings equation is a principled interpretation of the Takings Clause. Over the years, the Court has steadfastly viewed the purpose of the Fifth Amendment's Takings Clause to prevent government from forcing one property owner "alone [to] bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). For the greater good, the property owner yields the land but his loss is mitigated by the payment of compensation and the burden of paying is shared by the public by use of public funds. As explained in *Pennsylvania Coal*, the Takings Clause prevents government from "forgetting that a strong

public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." 262 U.S. at 416.

A concern for excessive economic impact does not enter into the antecedent question of whether a law substantially advances a legitimate state interest. That question is applicable to all legislation and is grounded on the proposition that there are some things government may not do under any circumstance. The Takings Clause only comes into play where an otherwise valid measure is alleged to have gone too far and extracted too much. It is at this point that the "fairness and justice," which are the guideposts for the Takings Clause, come into play. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 334 (2003).

B. No explanation has been forthcoming as to how the substantially advances test fits within either the language or purpose of the Takings Clause.

The entry of the "substantially advance" language into the takings lexicon was either a mistake or a momentous change in takings jurisprudence that was announced without fanfare or explanation. The former is the more likely explanation. *Agins v. City of Tiburon*, 447 U.S. 255 (1980), drew the substantially advances test from *Nectow v. City of Cambridge*, 277 U.S. 183 (1928), a substantive due process case.[2] The Court in *Agins* said:

[2] While the declaration in *Agins* is commonly viewed as the source of the supposed incorporation of the Fourteenth Amendment test into

(Continued on following page)

> The application of a general zoning law to particular property effects a taking if the ordinance does not substantially advance legitimate state interests, see *Nectow v. Cambridge*, . . . , or denies an owner economically viable use of his land, see *Penn Central*. . . . The determination that governmental action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest.

447 U.S. at 260.

Glaringly absent from the above quoted language is an explanation that links the *Nectow* rule in the first clause of the first sentence, that a valid exercise of the police power must substantially advance a legitimate state interest, to the ultimate goal set out in the second sentence of determining whether it is fair to burden a single landowner with the cost of an otherwise valid police power measure.

No principled explanation has been offered as to how a law that does not substantially advance a legitimate state interest can be a taking within the language or purpose of the Takings Clause. On numerous occasions the Court has stated that a regulation that does not substantially advance a legitimate state interest is a taking, but as the Court observed in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), it has yet to offer "a thorough explanation of the nature or applicability of the requirement that a regulation substantially advance

the Fifth Amendment, two years earlier, the Court used "substantially advances" language in *Penn Central*.

legitimate public interests outside the context of required dedications or exactions." *Id.* at 704.[3] Lower courts have likewise failed to explain how the test fits within the Fifth Amendment. This lack of an explanation is understandable since, outside the context of physical exactions, a regulation that does not substantially advance a legitimate state interest cannot be viewed as the functional equivalent of a physical appropriation, the touchstone of the regulatory takings doctrine.

In most of the instances when the Court has expressed the *Nectow* or *Agins* substantially advances language as a takings test, it has done so in dicta. On the few occasions when the Court has applied the test and said that a particular regulation is not a taking because it passes the substantially advances test, it has not only not paused to discuss why it is relevant to ask that question but in those cases, the landowner's so-called takings claim was in fact an effort to secure an invalidation of the law in question, not to seek compensation. In *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987), the Court declared the Pennsylvania prohibition of mining so as to cause surface subsidence substantially advanced a state interest and then moved on to the question of economic impact. The answer to the former question was virtually a given, and, while four justices dissented, none took issue with this conclusion. The serious question of the case for the majority and the dissent was whether the

[3] Five members of the Court have expressed serious reservations about the test, see *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998) (Kennedy, J., concurring in the judgment but dissenting in part, and, Breyer, J., joined by Stevens, J., Ginsburg, J., and Souter, J., dissenting.

statute went too far in the economic harm it imposed on owners of the mineral estates.

In *Del Monte Dunes,* the Court upheld the trial judge's decision to allow the jury to determine the city's takings' liability, which included ascertaining whether the city's permit denials substantially advanced the stated purposes of its regulations. Since the city itself had proposed the jury instructions that included the *Agins* question, the Court "decline[d] the suggestions of amici" to address the issue. 526 U.S. at 704. These uses of the substantially advances test hardly constitute endorsements of the test since its application was not contested in *Keystone* and was assumed in *Del Monte Dunes*.

It is not a strong endorsement of *Agins* as a takings test to say that the courts have repeated it often. Yet, no other reason is forthcoming. Repeated inconsequential reiterations should not be used to knowingly validate a test that stems from an erroneous reading of authority and cannot be tied to the language or purposes of the Takings Clause. Merely wishing to have intermediate scrutiny applied to regulations of property is also insufficient.

C. The historical confusion between due process and regulatory takings led to the mistaken application of the substantially advances test of the former into the latter.

Confusion has been a constant companion of the regulatory takings doctrine. This confusion can be traced to the doctrine's origins, which is usually said to have been the 1922 *Pennsylvania Coal v. Mahon* decision. 260 U.S. 393 (1922). With the advantage of hindsight we can look back and say that the regulatory takings doctrine originated

in the 1922 *Pennsylvania Coal* decision, but at the time the decision was handed down it was not clear that anything new had been done. When the Court spoke of regulations as takings in *Pennsylvania Coal*, it was difficult to distinguish that idea from then prevailing views of substantive due process.[4]

In the latter part of the Nineteenth Century and early Twentieth Century, the jurisprudence of the Court was that the validity of a police power regulation depended on whether the measure promoted the public interest by a means reasonably necessary to accomplish the purpose and was "not unduly oppressive upon individuals." *Lawton v. Steele*, 152 U.S. 133, 137 (1894). *Pennsylvania Coal*'s holding that otherwise valid regulations that went "too far" were takings in effect restated the *Lawton* due process "unduly onerous" test. The result has been a confusion of tongues and minds, as courts have spoken of "due process takings." *See Williamson County Regional Planning Commission v. Hamilton Bank of Johnson City*, 473 U.S. 172, 199 (1985); *GJR Investments, Inc. v. County of Escambia*, 132 F.3d 1359, 1364 (11th Cir. 1998).

Certain features of the *Pennsylvania Coal* opinion caused or aided this confusion. The state by definition must be a party to a takings claim yet the case was between private parties. The Takings Clause has a self-executing compensation remedy, but invalidation, not compensation, was the remedy awarded. In other words

[4] For a complete historical analysis, see Edward J. Sullivan, Emperors and Clothes: The Genealogy and Operation of the *Agins*' Tests, 33 Urb. Law. 343, 345-348 (2001). *See also* Julian C. Juergensmeyer and Thomas E. Roberts, Land Use Planning and Development Regulation Law § 10.9 (Thomson-West 2003).

what happened in the case duplicates what would have happened had the Court not mentioned the Takings Clause and relied instead on the Fourteenth Amendment's Due Process Clause. So great was the confusion that it was not known for decades whether the remedy from a regulatory taking was a Fourteenth Amendment declaration of invalidity coupled with an injunction or a Fifth Amendment taking requiring the assessment of compensation due. The historically accurate reading is merely an academic point today.[5] But, the fact of the confusion is of great importance because it goes to the heart of the error made by the Ninth Circuit in this case.

The confusion created by *Pennsylvania Coal* between due process and takings concerned the excessive impact of a regulation, not whether the regulation substantially advanced a legitimate state interest. For Justice Holmes the legitimacy of the action was a given:

> We assume, of course, that the statute was passed upon the conviction that an exigency existed that would warrant it, and we assume that an exigency exists that would warrant the exercise of eminent domain. But the question at bottom is upon whom the loss of the changes desired should fall.

Pennsylvania Coal, 260 U.S. at 416.

[5] Professor James Ely notes that the Court had intimated that regulations could become takings before 1922. *See* James W. Ely, Jr., The Fuller Court and Takings Jurisprudence, 1996 J. Sup.Ct. History, vol. II at 120. Then again, Professor Brauneis notes problems with viewing *Pennsylvania Coal* itself as a takings case. *See* Robert Brauneis, The Foundation of Our "Regulatory Takings" Jurisprudence: The Myth and Meaning of Justice Holmes's Opinion in *Pennsylvania Coal v. Mahon*, 106 Yale L.J. 613 (1996).

The confusion, instead, dealt with the third "unduly onerous" prong, which came to be confused with the "too far" test. Consequently, some courts viewed *Pennsylvania Coal* as a due process case, believing that Justice Holmes spoke merely "symbolically" in using takings language or as this Court said in *Williamson County*, he may have spoken "loosely." 472 U.S. at 198.

In *Goldblatt v. Town of Hempstead*, 369 U.S. 590 (1962), the Court distinguished between takings and due process. The Court there held that a ban on excavation as applied to a sand and gravel business was not a taking because there was no showing of a reduction in the value of the property. *Id.* at 594. After reaching this conclusion, the Court looked at the validity of the ban, concluding that it did substantially advance a legitimate state interest. In reaching this conclusion this Court did not mention the Takings Clause but the Court did rely on the leading substantive due process case of *Lawton v. Steele*, 152 U.S. 155 (1894). *Goldblatt*, 369 U.S. at 594. Despite *Goldblatt*, the confusion reemerged in *Agins*.

First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 482 U.S. 304 (1987), partially resolved the confusion by settling the debate as to whether claims of excessive economic impact were actionable under the Takings Clause. The Court there held that regulations that went "too far," or, put another way, were excessive in their impact upon the affected property owner, were real, as opposed to symbolic, takings. Thus, a judicial finding of a taking by regulation triggered the "self-executing compensation remedy" of the Takings Clause. *First English*, *Id.* at 315.

A lingering question as to claims of severe economic impact from regulations is whether the Takings Clause is the exclusive home to such claims. The question is answered by the doctrine that where there is an explicit textual source in the constitution it must be used to determine liability rather than generalized notions of substantive due process. *See Graham v. Connor*, 490 U.S. 386 (1989) (claims of excessive force during arrest must be brought under the Fourth Amendment) and *Whitley v. Albers*, 475 U.S. 312 (1986) (injuries suffered in a prison riot must be heard under the Eighth Amendment). Though the Fifth Amendment is not an explicit textual source for compensation from excessive regulations, the reasoning of *Graham* and *Whitely*, as well as *Pennsylvania Coal* and *First English* call for application of the rule.

While this Court has not specifically addressed whether the Fifth Amendment Takings Clause qualifies as sufficiently explicit under the *Graham-Whitley* doctrine, the functional equivalence of regulatory takings to physical appropriations should yield that conclusion. And several circuit courts have so held. *See Banks v. City of Whitehall*, 344 F.3d 550 (6th Cir. 2003); *John v. City of Houston*, 214 F.3d 573, 583-583 (5th Cir. 2000). There is no merit in having two independent yet virtually identical causes of actions. Thus, allegations of excessive economic impact should be exclusively within the province of the Fifth Amendment's Takings Clause. But, that does not mean that allegations of arbitrary legislation likewise should be subsumed by the Takings Clause. *See* Julian C. Juergensmeyer and Thomas E. Roberts, Land Use Planning and Development Regulation Law § 10.12 C (Thomson-West 2003).

While the *Graham-Whitely* issue is not directly before the Court in this case, it is important to recognize its relevance to clarifying the distinction between regulatory takings and due process. The thrust of those cases, along with *Pennsylvania Coal* and *First English*, is that at the most the Due Process Clause can provide a check on the validity of legislation, while the Takings Clause deals with the question of whether otherwise valid government actions either confiscate or effectively confiscate property so as to become takings.

The strand of confusion that remains is the one in this case and it is of more recent origin, dating back only to the 1980 *Agins* case. The Court can remove that confusion in this case by applying the principled standard of the Takings Clause that has heretofore guided its decisions: The Fifth Amendment regulatory takings claim assumes the legitimacy of the regulation but demands that where the effect of the regulation is so great that it is the functional equivalent of a physical appropriation the landowner must be compensated.[6]

[6] Legitimacy of the exercise of eminent domain must of course be shown to meet the Public Use clause. That issue and such public use cases like *Hawai'i Housing Authority v. Midkiff*, 467 U.S. 229 (1984) and *Kelo v. City of New London*, 268 Conn. 1, 843 A.2d 500 (2004), *cert. granted*, 125 S.Ct. 27, 73 USLW 3178, 73 USLW 3204 (Sep. 28, 2004) (NO. 04-108) are different from regulatory takings actions in that they check unlawful government action rather than compensate for excessive regulation.

D. *Nollan's* essential nexus test applies to physical exactions, and is not dependent on the substantially advances test.

In *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), the Court applied the "substantially advances" test in the context of a physical exaction. The Court purportedly used the *Agins* test to find a taking but, though superficially applicable to the facts of the case, the *Agins* formulation was irrelevant to the holding reached in the case. In *Nollan*, when the owners of a beachfront lot sought permission to build a larger house, the state coastal commission conditioned the permit on the granting of an easement to allow the public to walk along the beachfront side of the lot. The Court had no quarrel with the legitimacy of the state-asserted interests (to protect the public's ability to see the beach from the street, to prevent congestion on the beach, and to overcome psychological barriers to the use of the beach resulting from increased shoreline development), but the Court was not convinced that the required lateral access easement along the beach front would promote them.

While this Court in *Nollan* found that the interests asserted by the state would not have been substantially advanced by the easement sought, the Court's concern was the state's justification for singling out the Nollans to contribute land for the public use, which the Court found wanting. The lack of a sufficient nexus between what the Nollans proposed to do and what the state was asking in return led the Court to conclude that the state's problems were not of the Nollans' making. If California wanted an easement, the Court said it would have to pay for it. This was the heart of the opinion. What was important was not whether the law substantially advanced a legitimate state

interest but whether the government was attempting to force the property owners "alone bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

Although the regulation at issue in *Nollan* did not substantially advance a legitimate state interest, the question did not need to be asked in order to decide whether a taking had occurred. While the means and ends did not link up in *Nollan*, imagine what would have happened had the state "come clean" so to speak, and simply admitted that it wanted the easement to aid public passage on the beach. Obtaining an easement unquestionably would have substantially advanced a legitimate state interest, and thus not run afoul of the *Agins* test. No one, however, would contend that it therefore was not a taking. Yet, that is where *Agins* leads.

Nollan does not deal with issues of regulatory takings but rather establishes the essential nexus test for physical exactions. When the state conditions development permission on a landowner dedicating property to public use it may do so without paying compensation only if the dedicated land is "reasonably necessary," *Nollan*, 483 U.S. at 834, to prevent or counteract anticipated public effects of the landowner's actions. The only difficulty with *Nollan* is that asking the wrong question runs the risk of unfair results in that it does not answer the question of who should bear the burden in question. The corrective step needed is to recognize that the use of the word "substantially" was unnecessary to the essential nexus test. A land exaction may be required because of its use or because of its location. While acquiring the land by either method substantially advances a legitimate interest, compulsory

dedication should only be imposed on those whose use is related to the interest the state is promoting. Those who own land the state happens to need but who are not contributors to or involved in the project or program that creates the need should be compensated.

In *Dolan v. City of Tigard*, 512 U.S. 374 (1994), the Court added a rough proportionality requirement to physical exactions. In *Dolan*, the Court remanded a case to the state court requiring the city to show that its demand for land for a greenway and pedestrian pathway was roughly proportional to the new burdens that would be placed on the city by the landowner's increased development.

The *Nollan* and *Dolan* requirements, that government carry the burden of justifying the need for exacting land, are based directly on the language of the Takings Clause. Physical takings of land must be compensated unless the state can show that the exaction is a legitimate condition of development permission. Planners have incorporated these rules into the planning process. A year after the *Dolan* decision, *Amicus* American Planning Association incorporated the principle of fact-based decision-making in its 1995 Policy Guide on Takings.[7] The Policy Guide advises planners to establish a sound basis for land use and environmental regulations through comprehensive planning and background studies. The Policy Guide states that "a thoughtful comprehensive plan or program that sets forth overall community goals and objectives and which establishes a rational basis for land use regulations

[7] American Planning Association, Policy Guide on Takings (April 1995). http://www.planning.org/policyguides/takings.html.

helps lay the foundation for a strong defense against any takings claim." *Id.*

II. The invalidation remedy that necessarily follows from a finding that a law does not substantially advance a legitimate state interest contradicts the express, self-executing compensation remedy of the Takings Clause.

The Ninth Circuit's invalidation of Hawaii's law turns a blind eye to the self-executing compensation remedy of the Takings Clause and thereby reveals the *Agins* masquerade. In *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987), the Court held that the remedy for a regulatory taking, as with a physical taking, is compensation. As discussed above in Part I. C., this decision ended the debate as to whether the *Pennsylvania Coal* decision spoke merely symbolically of excessive regulations as takings by concluding that it did not. A regulatory taking was a true, not a symbolic, taking, insofar as the self-executing compensation remedy is concerned. 482 U.S. at 315. As Justice Kennedy has explained:

> The [Takings] Clause operates as a conditional limitation, permitting the government to do what it wants so long as it pays the charge. The Clause presupposes what the government intends to do is otherwise constitutional.

Eastern Enterprises v. Apfel, 524 U.S. 498, 545 (1998) (concurring in the judgment and dissenting in part).

An act that does not substantially advance a legitimate state interest as required by the federal constitution is void, *Nectow v. City of Cambridge*, 277 U.S. 183 (1928),

and a void act cannot be a taking. Allowing an ordinance found to not substantially advance legitimate state interests to remain in effect by treating it as an exercise of the power of eminent domain is not constitutionally permissible. Yet, the plain meaning of the *Agins* formula coupled with the express mandate of the Fifth Amendment means that an ordinance that does not substantially advance a legitimate state interest can remain in force if compensation is paid.

Numerous courts have made the point that where an ordinance is invalidated as an improper exercise of the police power, any loss sustained for the period the ordinance applied to the property is not a compensable exercise of the power of eminent domain. *Pheasant Bridge Corp. v. Township of Warren*, 169 N.J. 282, 777 A.2d 334, 343 (2001), *cert. denied*, 535 U.S. 1077 (2002), *Sea Cabins on Ocean IV Homeowners Ass'n, Inc. v. City of North Myrtle Beach*, 345 S.C. 418, 548 S.E.2d 595, 604 (2001), *Miller & Son Paving, Inc. v. Plumstead Twp.*, 717 A.2d 483 (Pa.1998), *cert. denied*, 525 U.S. 1121 (1999), *Landgate, Inc. v. California Coastal Commission*, 17 Cal.4th 1006, 953 P.2d 1188, 1195, 73 Cal.Rptr.2d 841, 848, *cert. denied*, 525 U.S. 876 (1998). *See also Board Machine, Inc. v. U.S.*, 49 Fed.Cl. 325, 328 (2001) (unauthorized action of government official not within the purview of the takings clause). *See generally* John D. Echeverria, Taking and Errors, 51 Ala.L.Rev. 1047 (2000).

Since the exercise of the power of eminent domain requires legitimate government action, a judicial finding of illegal or unauthorized action precludes the constitutional trigger of compensation. Even if the period of time from application to declaration of invalidity were viewed as a taking for a public use, that would not end the inquiry. A

second analysis would follow under the *Penn Central* factors to determine whether a taking had occurred.

While retrospective monetary relief could be labeled compensation for a temporary taking, characterizing a monetary award for the past effects of a law found invalid for failing to substantially advance a legitimate state interest as a taking means that the government took property by an illegal act. Since an award of just compensation "presupposes what the government intends to do is otherwise constitutional," *Eastern Enterprises*, 524 U.S. 498, 545 (1998) (Kennedy, J., concurring in the judgment and dissenting in part), awarding compensation for something the government did unconstitutionally is a constitutional impossibility.

Despite the Fifth Amendment's self-executing compensation remedy for a taking, *First English*, 482 U.S. at 315, the Court has recognized that an exception must be made in the unusual situation where monetary relief would be ineffective. For example, in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), coal companies sued to escape having to pay money into a retirement fund for miners. Finding the act to impose retroactive liability and constitute a taking, it made no sense to have the coal company comply with the law by paying money into the fund (and thus complete the taking) only to turn around and order the fund to give the money back to the coal company as compensation. But, as Justice Kennedy pointed out in his concurrence, this feature itself suggested that the takings clause was inapposite. 524 U.S. at 540.

Invalidation is the exception, not the rule. Asking that invalidation be recognized as a commonplace remedy for a

taking reveals the flawed basis of the Respondent's argument.

III. Incorporating the substantially advances test into the Takings Clause in order to apply intermediate scrutiny to judge the wisdom and efficacy of government regulation undermines the legislative process and compromises orderly planning.

A. The legislative and planning processes followed across the country, particularly at the local level, are the epitome of participatory democracy and deserve to be accorded substantial deference by the Court.

The planning and legislative processes that local governments use to consider, formulate, and adopt regulations are by their very nature participatory. Property owners, special interest groups, and members of the general public have ample opportunity to make their views known before elected officials adopt policies that will govern community affairs. If members of the public disagree with decisions made they have an opportunity to seek relief through the legislative or administrative appeals processes. In many states, they can engage in direct lawmaking by use of the initiative or referendum. And, they have the power at the polls to turn out of office those they believe have not served them well.

The appropriate way to promote the public's involvement in the development of state and local laws and regulations is through a democratic process that allows for public debate and deliberation based on studies designed to evaluate alternative approaches to achieving community objectives. The process may be time-consuming but

democracy often is. For example, this Court recognized the importance of the decision making process in *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302 (2002), observing that the moratorium imposed by the regional agency allowed it "to obtain the benefit of comments and criticisms from interested parties, such as the petitioners, during its deliberations." 535 U.S. at 340. The district court in *Tahoe-Sierra* noted the complexity of the planning task, and found the agency had acted reasonably and in good faith, and did not waste time in enacting a new plan. 34 F. Supp. 2d 1226, 1250 (D. Nev. 1999). Courts should defer to the legislative judgments that flow from this process.

Involving the public in formulating legislation through public review and comments are concepts that are integral to the planning process. The Code of Ethics of the American Institute of Certified Planners,[8] whose membership includes more than 14,000 certified professional planners, places particular emphasis on the planning profession's special responsibility to serve the public interest and to involve the public in the process of balancing among divergent interests. To the planning profession the public interest is not an abstract concept but rather a set of principles that is defined through debate and with the full participation of citizens. To that end, the planner has special obligations that include striving to provide full, clear and accurate information on planning issues to citizens and governmental decision-makers. The planner's Code of Ethics requires that every effort be made "to give

[8] The American Institute of Certified Planners, known as AICP, is a subsidiary institute of *amicus* American Planning Association. http://www.planning.org/aicp/

citizens the opportunity to have a meaningful impact on the development of plans and programs. Participation should be broad enough to include people who lack formal organization or influence.'"[9] Endorsing the Ninth Circuit's second guessing of legislation would undermine the public's role in defining the public interest. And, as Judge J. Harvie Wilkinson has observed, in these times we can ill afford to do this:

> The very impersonality of global trends and national bureaucracy will leave state and local governments among the few places where a sense of civic connection with governing institutions can still be felt.

J. Harvie Wilkinson, III, Chief Judge, United States Court of Appeals for the Fourth Circuit, "Is There a Distinctive Conservative Jurisprudence?" 73 U.Colo.L.Rev. 1383, 1392-93 (2002).

B. Judicial second-guessing destroys the public effort that the planning process embodies.

Intermediate judicial scrutiny is neither needed nor justified to protect those who are well represented in legislative halls. Property owners, developers, and financial institutions, along with special interest groups such as homebuilders and realtors associations, as well as environmental organizations, all have an opportunity to speak up on how their communities should develop and grow. The economic and political influence of those wishing to

[9] AICP Code of Ethics and Professional Conduct (Adopted October 1978, amended October 1991).

develop land or to prevent land from being developed will wax and wane. One group will be strong in some communities and weak in others. Legislators who disfavor growth will be replaced by those who favor growth or vice-versa. But those who are affected, particularly property owners, have a powerful voice in what happens.

The Court recognized in *Dolan v. City of Tigard* that "cities have long engaged in the commendable task of land use planning, made necessary by increasing urbanization." 512 U.S. 374, 396 (1994). Engagement in this task calls for a process that may be messy at times and may result in laws that are imperfect in design, but those imperfections are the essence of our democratic system. To permit a judge who thinks a law is imperfect or unwise, with the stroke of a pen, to undermine this democratic process violates the fundamental mandate of our constitutional government that separates the legislative, judicial, and executive branches.

CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, *et al.*,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo*, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

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BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute was established in 1977 as a non-partisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1989 to help restore the principles of limited constitutional government, especially the proposition that the U.S. Constitution establishes a government of delegated, enumerated, and thus limited powers. Toward that end, the Institute and the Center undertake a wide range of publications and programs, including, notably, the annual *Cato Supreme Court Review*. Counsel of Record for this brief is Professor Richard A. Epstein, a leading constitutional law scholar. The instant case raises squarely the question of the limits on state governments' power under the Takings Clause and is thus of interest to the Cato Institute and its Center for Constitutional Studies.

STATEMENT

1. Hawaii Act 257 ("Act 257" or "the Act") establishes an elaborate rent control scheme applicable to oil and gas companies ("landlords") that lease gas stations to in-state independent dealers ("tenants"). The Act stipulates that a landlord may charge its tenants a rent that exceeds the sum of (1) 15 percent of the tenant's gasoline profit and (2) 15 percent of the tenant's gross profits on any products other than gasoline. Pet. App. 2-3.

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[1] Pursuant to this Court's Rule 37.3(a), letters of consent from all parties to the filing of this brief have been submitted to the Clerk. Pursuant to this Court's Rule 37.6, *amicus* states that this brief was not authored in whole or in part by counsel for any party, and that no person or entity other than *amicus* or its counsel made a monetary contribution to the preparation or submission of this brief.

2. The Act also interferes with the landlord's right of possession. Ordinarily, of course, the right of possession permanently reverts to the landlord at the expiration of a lease's term. The Act, however, bars landlords from converting a leased gas station, run by a tenant dealer, into a company-run gas station when an existing lease expires. Pet. App. 2.[2] It also requires lease renewal terms to be "construed" to grant incumbent tenants a three-year term, as of the operative date of the statute. Pet. App. 3. Finally, it bars the landlord from opening a company-run gas station within a given geographic proximity to the existing, rent-controlled tenant-run gas station. Pet. App. 3. As a result, the Act entrenches incumbent tenants, who are more difficult to remove from the landlord's distribution system.

3. The Act reduces landlords' flexibility to price their goods and services. For example, respondent Chevron ("respondent" or "Chevron") decided to change its general leasing formula, not only in Hawaii but throughout the United States, in order to increase financial returns (a unilateral price change legal under the antitrust laws so long as Chevron does not act in concert with its rivals.)[3] *See Chevron USA, Inc. v. Lingle*, 363 F.3d 846, 848 (9th Cir. 2004). Act 257's rent control provisions, however, effectively prevent such increases and/or block future rent increases in excess of those allowable under the statute.[4]

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[2] The Act grants a limited exception, in cases where the tenant either has abandoned the property or the lease is not properly renewed, only if the landlord is not able to immediately replace the tenant with a new local independent dealer. Pet. App. 2-3. The exception lasts "until a [new] dealer may be found" and is capped at 24 months. Pet. App. 2-3.

[3] *Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986).

[4] To be sure, the Hawaii statute does allow for some additional rent increases, which are tied to the increase in the level of ground rents. Pet. App. 3. But it makes no provision whatsoever for rent increases attributable to, say, enhanced demand for gas brought about by

4. Under the Act, a tenant leasing an oil company's property is not required to pass any savings it receives under the statute to customers; gas station consumers can be charged the same prices for gasoline and for other goods and services that they were charged before the passage of the Act. Nor does the Act impose restrictions on the prices that the incumbent tenant is able to charge when assigning its leasehold interest to a third-party ("sub-tenant"). As a result the tenant can "lease-out" the landlord's property to sub-tenants for the same price the landlord could have charged in Act 257 had not been passed.

5. The Act is not justified by reference to any existing anticompetitive harm stemming from the structure of the oil market. Instead, petitioners justify the Act based on the risk of future "economic harm" that might occur if the "wholesale market . . . *were* to become concentrated in the hands of the few oil companies serving the islands." Pet. Br. 4 (emphasis added). *See also id.* at 9 & n.4. That risk is wholly hypothetical, as it has not materialized in the many decades in which gasoline has been sold in Hawaii.

6. Act 257 effectively transfers the wealth of the landlord, an out-of-state company, to independent in-state tenants, who are local citizens and voters. So long as these tenants remain in possession, they benefit from the rent reductions that Act 257 mandates. When the tenants, in turn, assign their property to sub-tenants, the statute permits them to charge a premium equal to the present discounted value of the statutory savings under the Act. Put another way, the sub-tenant pays the same amount for the sub-lease that it would pay if the rent control statute were not in effect, but a portion of this payment (the "premium") goes to the tenant, rather than to the landlord. Viewed from a purely financial perspective, consumers are made neither better nor worse off

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population growth. As explained in Part II, such "demand-side" increases are taken by the statute from the landlord and given to the present tenant in possession of the property.

by Act 257, which merely shifts wealth from landlords to incumbent tenants.

7. Respondent challenged the statute under the Takings Clause, alleging that the rent control provisions take Chevron's property without just compensation. The district court and the Ninth Circuit ruled in respondent's favor. *Chevron USA, Inc.* v. *Cayetano*, 198 F. Supp. 2d 1182 (D. Haw. 2002), *aff'd Chevron v. Lingle*, 363 F.3d 846 (9th Cir. 2004). On appeal, petitioners contend that the choice between the Due Process Clause and Takings Clause should affect the standard of review brought to bear. The Due Process Clause is said by petitioners to require an extremely deferential standard of scrutiny.

SUMMARY OF ARGUMENT

The question put to this Court is straightforward: Does Act 257 serve any conceivable public interest? The answer is equally clear: Its sole effect is to confiscate a landlord's property rights for the benefit of in-state tenants. The economic analysis is both simple, and stark: The Act extinguishes the landlord's right to raise the rent on current tenants. He therefore cannot capitalize on appreciation of leasehold property. Existing tenants, by contrast, are granted the power to sublease the landlord's property to a third party, and may do so free from any rent restrictions. As a result, the tenant is given the power to profit from the rising value of the landlord's property. This is confiscation, pure and simple.

This statute cannot be justified as a land use restriction, because it does not change the use of the property. Nor is it plausibly justified as a remedy for monopoly behavior, since Hawaii makes no showing that the gas companies violated antitrust laws. Indeed, Hawaii concedes that the Act will not lower prices currently charged consumers, the traditional goal of antitrust policy. *See, e.g.*, Pet. Br. 9 n.4 (the States "did not contend . . . that Act 257 would have the effect of reducing current prices"; rather, the goal of the Act is to prevent a potential price increase that might occur sometime

in the future).[5] From whatever angle this statute is analyzed, the same conclusion follows: Act 257 accomplishes a naked transfer of wealth to a discrete class of preferred local residents who are entrenched not only in their leasehold interests but, so far as it appears, in their jobs as well. This entrenchment makes this statute far more intrusive than the ordinary rent control law. In short, it lacks any sensible public justification. Whether its decision is analyzed under the Due Process Clause or the Takings Clause, the court of appeals should be affirmed.

ARGUMENT

I. THE CHOICE BETWEEN THE TAKINGS AND DUE PROCESS CLAUSES DOES NOT CHANGE ANALYSIS.

Both the decision below and petitioners' briefs before this Court expend pages arguing that the Due Process Clause and the Takings Clauses compel different results on the facts of this case. That debate, however, is wholly irrelevant to the outcome here. To see why, it is useful to review the array of harmful private conduct that the state may combat through its police powers. That inquiry throws the constitutional flaws of Act 257 into sharp relief, no matter the avenue of analysis invoked, by underscoring that petitioners have not identified a public purpose that justifies the Act's interference with Chevron's property interests.

1. As an initial matter, in dealing with human events, it is generally safe to assume that most individuals understand their own interests, and thus should be free to act in whatever fashion they see fit. Nonetheless, that presumption, whether applied to one's person or property, has never been absolute, even in the eyes of the most ardent advocates of laissez faire principles. *See* Lord Bramwell, *Laissez Faire* 8 (1884) ("All

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[5] *Compare Blue Shield of Va. v. McCready*, 457 U.S. 465, 475 n.11 (1982) (antitrust policy designed to deter "tangible," rather than "speculative," economic harm).

that the advocates of laissez faire demand, is that freedom of contract shall not be interfered with without good reason."). As a result, the vast majority of debates over the propriety of regulatory intervention inevitably collapse into debates about the state's *burden* of justification.

It is clear that some scrutiny of state purposes is constitutionally necessary: This is a clear implication of the text of the Takings Clause, which contains an explicit set of substantive requirements: "Nor shall private property be taken for public use without just compensation." U.S. Const. amend. V. The first question posed by the Clause is whether dispossession of property serves a "public use." That restraint prevents the state taking property from A and giving it to B, and forces courts to closely consider whether a taking truly serves a general public interest.

Here, the "public" purpose putatively advanced is the control of oligopoly. *See Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229 (1984) (suggesting that the control of oligopoly—the very interest asserted by Hawaii in this case—may justify transfer of property from landlords to sitting tenants). In our view, this allegation, and indeed all assertions of public use, deserves scrutiny. *See* Brief of Cato Institute as *Amicus Curiae* in Support of Petitioners, *Kelo v. City of New London*, No. 04-108. Rent control systems necessarily interfere with the landlord's power over his premises. It is therefore fair to require a showing that some real public interest is advanced in fact by the state's constructive transfer of property interests from the landlord to the tenant.

2. The absence of any public interest at issue in this case, whether scrutinized under the Due Process or Takings Clause, is underscored by reference to state police powers. Consider, first, the least controversial class of abuses that may be addressed by the police power: nuisances. Everyone (even those who adopt the most aggressive interpretation of due process and takings law) concedes that the state, as an agent of the public at large, may confront and control

common law nuisances. *See, e.g., Fertilizing Co. v. Hyde Park*, 97 U.S. 659 (1878); *Lucas v. South Carolina Coastal Comm'n*, 505 U.S. 1003, 1023-30 (1992) (discussing nuisance limitations). Moreover, the degree of state power should be large enough to deal with the full range of incompatible uses that often arise between neighbors. To be sure, imposition of zoning restrictions to accomplish the same end is controversial. But in these cases, too, courts have generally sustained zoning regulations pursuant to this Court's decision in *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).[6] Nuisance is not at issue here, because this case does not raise issues about the nature of the land use in question. The gasoline stations at issue will be put to the same uses no matter whether Act 257 survives or is struck down.[7] Any deferential standard appropriate to nuisance or land use regulations is therefore inapplicable.

The second class of potential abuses that may be addressed by a state's police power is monopoly pricing. The danger here is that any person possessed of exclusive power to sell a given commodity will charge an anticompetitive price, generating resource misallocations. A system of rate regulation is often adopted by states under these circumstances to prevent that misallocation. Even so,

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[6] *Agins*, which states that a regulation must "substantially advance[] a legitimate state interest," was a land use decision, and the *Agins* test is, like *Euclid*'s, just such a deferential standard of review. *See, e.g., Agins v. City of Tiburon*, 447 U.S. 255, 261 (1980) (upholding a five-acre minimum lot requirement, based on state's asserted desire to prevent the "ills of urbanization"). In our view, however, *Agins* went far beyond the anti-nuisance rationales that form the appropriate bases for state intervention, because it failed to show that, on average, the lot requirement worked to the reciprocal advantage of neighbors.

[7] For, example, height restrictions raise externality problems that are not found in any rent control statute, including Act 257. *See* Richard A. Epstein, *Rent Control and the Theory of Efficient Regulation*, 54 Brooklyn L. Rev. 741, 747 & n.9 (1988).

courts have recognized a need for constitutional intervention to prevent state officials from pushing the rates so low that the regulated monopolist will not be able to recover its initial capital investment plus a reasonable rate of return. There are many different ways in which to calculate the rate base and the associated rate of return. *Contrast Smyth v. Ames*, 171 U.S. 361 (1898) (rate base consists of property used or usable in the business), *with Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591 (1944) (rate base equal to capital invested). But no matter which test is used, these "rate cases" always call for some stricter standard of scrutiny than the land use cases. They involve simple financial transactions, in which there is no need to balance neighboring property interests. The only state interest is guaranteeing access to, and preventing the mis-pricing of, essential services supplied by a natural monopolist. In this case, however, petitioners have not even shown the existence of monopoly power, much less its abuse. They have made no showing of any present competitive harm, nor a violation of antitrust laws. Act 257 is merely designed to prevent the speculative risk of a *hypothesized* concentration of retail market power by oil companies sometime in the future. *See* Pet. App. 4 (asserting aim of the Act is to prevent the future "economic harm" that "would occur *if* the retail market were to become concentrated") (emphasis added).[8]

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[8] *Compare McCready*, 457 U.S. at 475 n.11 (antitrust designed to combat "tangible," rather than "abstract" or "speculative," conceptions of economic harm). Given that the statute expressly protects local distributors from competition with company-owned stations (*see, e.g.*, Pet. App. 3 (limiting company power to open stations in proximity to leased stations)), Hawaii's putative interest in competition rings particularly hollow. *See, e.g., Brunswick v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 488 (1977) (rejecting claims of small competitors premised on putative injury that resulted from acquisitions of competitor, because antitrust laws were enacted for "the protection of *competition*, not *competitors*") (emphasis added).

A third possible state regulatory interest is remedying danger or hardship to workers. The petitioners constantly refer to this Court's decision in *Lochner v. New York*, 198 U.S. 45 (1905), as the fountain of all evils. In fact, the *Lochner* Court considered whether a maximum hours statute was within the legislative power of a state, an interest in no way implicated here. Nor does this case involve the claims of retirees who have suffered reversals in the financial market as the result of retroactive changes to a state-funded retirement plan. *See, e.g., Railroad Retirement Bd. v. Alton R. Co.*, 295 U.S. 330 (1935) (striking down retroactive federal regulation of state pension plans, and holding such regulation is within the police power of the states).[9] Like nuisance laws and monopoly pricing, this is not an interest implicated by Act 257.

3. Unable to identify a concrete public purpose at stake, petitioners advocate a switch to due process scrutiny, which they claim permits extreme deference to any state ends that might be articulated in the course of litigation. *See, e.g.*, Pet. Br. 37, 38 & n.13. They seize on Justice Kennedy's partial dissent in *Eastern Enters. v. Apfel*, 524 U.S. 498 (1998) (scrutinizing retroactive regulation of state pension plans), to justify this analytical switch. *See, e.g.*, Pet. Br. 30. *Eastern Enterprises* struck down portions of the Coal Industry Retiree Health Benefit Act of 1992 ("Coal Act"), 26 U.S.C. §§ 9701-22, which retroactively imposed a tax on coal operators to fund pensions for former employees. 524 U.S. at 510-11. Four justices voted to strike down the Coal Act based on the Takings Clause. *Id.* at 529. However, Justice Kennedy reasoned that the tax in question did not attach to any discrete piece of property, making due process analysis more appropriate. *Id.* at 547 (Kennedy, J., dissenting in part). It is this divergent analysis that petitioners claim dooms the takings standard applied below. Pet. Br. 30.

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[9] *Alton* was subsequently limited in *Usery v. Turner-Elkhorn Mining Co.*, 428 U.S. 1 (1976) (allowing retroactive impositions for the support of a black lung disease compensation program for retired coal miners).

Petitioners' reliance on *Eastern* as a fount for distinguishing the substance of "takings" and "due process" scrutiny is misguided. It is useful to compare the due process analysis in *Eastern* to the line of cases going back to the first Justice Harlan's decision in *Chicago, Burlington & Quincy R.R. Co. v. Chicago*, 166 U.S. 226 (1897). *Chicago Railroad* involved the condemnation of railroad property for which a jury awarded only nominal compensation. In attacking that judgment, Justice Harlan did not rely on the Takings Clause, which at that time had not been applied to the state (*Barron v. Mayor of Baltimore*, 32 U.S. 243, 247 (1833)), but on the Due Process Clause. As he said:

> In our opinion, a judgment of a state court, even if it be authorized by statute, whereby private property is taken for the State or under its direction for public use, without compensation made or secured to the owner, is, upon principle and authority, wanting in the due process of law required by the Fourteenth Amendment of the Constitution of the United States.

Id. at 241. Justice Harlan's opinion mirrors the substance of takings analysis and illustrates that a choice between the Due Process and Takings Clauses should not compel different conclusions. *Compare Eastern Enters.*, 524 U.S. at 542 (Kennedy, J., dissenting in part) (holding, in the course of striking down the Coal Act under the Due Process Clause, that "the burden imposed by the Coal Act may be just as great if the Government had appropriated one of Eastern's plants").[10]

The constant effort to distinguish the various types of interests and claims furthered by different clauses of the

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[10] This should have been a common sense implication of *Eastern*, even without reference to Justice Harlan's opinion in *Chicago Railroad*, given that the four-vote plurality and Justice Kennedy came out the same way in that case: *against* the federal regulation at issue.

Constitution creates an endless proliferation of unnecessary interpretive problems. The simple truth is that whether analyzed under the Due Process or the Takings Clause, the analysis is the same, and the constellation of relevant state interests that ground analysis are the same. At a minimum, petitioners' failure to identify any legitimate "public" interest—whether nuisance or abuse of monopoly power—dooms their case. *See, e.g., Chicago Railroad*, 166 U.S. at 241; *compare Eastern Enters.*, 524 U.S. at 549-50 (Kennedy, J., dissenting in part) (due process inquiry, applied to retroactive legislation, requires inquiry into "purposes" of legislature, including whether legislation promotes "general welfare").

II. UNDER ANY AVAILABLE STANDARD, HAWAII'S RENT CONTROL SCHEME REPRESENTS A PARADIGMATIC VIOLATION OF THE TAKINGS CLAUSE.

A. Hawaii's Act 257 Fails Even The Deferential Takings Analysis Applied In The "Rate Cases."

In their plea for deference to Act 257, the petitioners make no reference to any ratemaking decision of this Court, even though the Act in practice imposes a form of ratemaking. These cases are instructive here, for, in the context of challenges to utility rates, this Court has long recognized that the Takings Clause requires scrutiny not only of the purpose of a rate regulation but also of ratemaking methodology. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1989). Review of the rate cases underscores two points: (1) that the exceedingly deferential "rationality" test proposed by petitioners is not the universal norm for "complex" regulatory questions; and (2) that petitioners fail even the relatively forgiving standard applied in the complex rate-setting context.

1. Hawaii boldly proclaims that Act 257 must be upheld "[e]ven if the legislature has not articulated a rationale for [the] law." Pet. Br. 38 n.15. Indeed, says Hawaii, "if 'any

state of facts either known or which could reasonably be assumed affords support for it,'" the Act must stand. *Id.* at 15. *See also id.* at 39 n.15 ("'Because we never require a legislature to articulate its reasons for enacting a statute, it is entirely irrelevant for constitutional purposes whether the conceived reason . . . actually motivated the legislature.'") (quoting *FCC v. Beach Communications*, 508 U.S. 307, 315 (1993)).

This test suffers in comparison to the deference afforded "complex" regulatory decision *par excellence*: rate-orders set by utility commissions. In *Duquesne Light Co. v. Barasch*, *supra*, the Court considered whether a state commission acted properly by refusing to add certain nuclear power plant expenditures, determined to be wasteful, to the rate base. The commission sought, and received, deference. Its argument was two-fold. First, it highlighted its use of a detailed method for valuation of the utility. Second, in response to complaints that its rate-setting methodology involved a number of disputed adjustments, the commission relied on this Court's statement in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), which stressed that a court must look at the effect of the rate on the utility's bottom line. *Id.* at 602.

In *Duquesne*, this Court agreed that some deference to the commission was appropriate. It underscored, for example, that, when the commission applies its rate methodology, individual errors of calculation do not rise to a constitutional dimension:

> The economic judgments required in rate proceedings . . . do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties. Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding.

488 U.S. at 314. It did not, however, abdicate scrutiny of the rate-order, as Hawaii implicitly advocates. First, the Court

underscored the importance of an administrative record (*id.* at 310-11 (noting that whether a rate order is just depends "to some extent on" evaluation of the "risks under a particular rate-setting system, and on the amount of capital which the investors are entitled to earn")). Second, the Court scrutinized the return as a percentage of the utility's equity and rate base. *Id.* at 311. Third, the Court took care to stress that more than one adjustment had been made to the rate. *Id.* at 314 ("Inconsistencies in one aspect of the methodology have no constitutional effect on the utility's property if they are compensated by *countervailing* factors in some other aspect.") (emphasis added). The rationale for the last qualification is akin to economic "portfolio theory": It is more reasonable to assume that errors in a particular adjustment are harmless when they may be "balanced out" by other adjustments.

The Court also underscored that judicial oversight, at a minimum, is necessary to ensure that a rate commission does not "arbitrarily" "require[] investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others." *Id.* at 315 (suggesting such an approach would raise "serious constitutional concerns"). Implicit in this proviso is that "deference" does not excuse a legislature's conclusory, or boilerplate, justification for a rate-change: As the Court itself emphasized, either the commission or the state legislature must have "performed" the requisite "work" necessary to "equitably reconcil[e]" the relevant regulatory interests at stake before deference is appropriate. *Id.* at 314. *See also Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) ("Judicial review . . . will function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act, as well as its assessment of the consequences of its orders for the character . . . of the industry"); *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1177 (D.C. Cir. 1987) (emphasizing "the necessity for Commission findings, the existence of which is a necessary predicate to judicial deference").

2. Applied to this case, *Duquesne* would require, at a minimum, a showing far greater than Hawaii has made to date. It would, for example, require a legislative record that evidences Hawaii's consideration of the valuation of Chevron's leasehold property, its capitalization, and its anticipated rates of return under Act 257. The Hawaii legislature, of course, made no such showing. *Compare* Pet. App. 1-2 (legislative findings). It would also require a showing that multiple adjustments could "balance out." But, here, only *one* adjustment was made: The rents were capped. There is no basis for a kindly presumption that this single blunt adjustment, if ill-considered, will harmlessly be "balanced" away.

Nor, for that matter, has Hawaii demonstrated that it deliberated about the need for the cap, as *Duquesne* implicitly requires. The Hawaii legislature, for example, adduces only barebones incantations of market "concentration." Pet. App. 1. That boilerplate is not accompanied by any concrete factual findings of the sort that even the most elementary notions of procedural due process would require. The minimalist findings of Act 257, for example, offer no concrete evidence that Chevron's putative market share is tantamount to monopoly power. *Compare United States v. Grinnell Corp.*, 384 U.S. 563 (1966). Nor does the legislative record offer evidence that the Hawaii legislature considered any of the relevant indicators of market concentration under federal or state law: including barriers to entry, price elasticity, and other factors relevant to definition of the product and/or geographic markets. *See, e.g., United States v. General Dynamics Corp.*, 415 U.S. 486 (1974) (discussing evidentiary requirements to show improper market concentration under Section 7 of the Clayton Act). Indeed, in an ever-shifting attempt to supply post-hoc justifications for the Act, petitioners now suggest the Act merely prevents future economic harm that might occur "*if* the retail market, like the wholesale market, were to become concentrated." Pet. Br. 4 (emphasis added).

The vacuous and shifting nature of the findings offered in support of Act 257 isn't surprising: After all, it is unlikely that a legislature has done the "work" necessary to reach a fair result if, as Hawaii says, the Takings Clause does not require a legislature to "articulate[] a rationale" (Pet. Br. 38 n.15) for regulatory intervention in the first place. *Duquesne* underscores that, at a minimum, some record of meaningful deliberation must exist if Hawaii is to qualify for deference. Lacking such a record, Act 257 fails even the deferential review owed rate commissions.

B. Act 257 Violates The Principle That Public Burdens Must Be Borne By The Public As A Whole, Making Heightened Scrutiny Appropriate.

While Hawaii fails the deferential standard articulated in *Duquesne*, rational basis should not be considered a ceiling on scrutiny of Act 257. Utilities are natural monopolies; as such, they are subject to public oversight, presumptively in the public interest, even if that oversight is prone to error. By contrast, rent control statutes carry a special risk: they may disguise a naked wealth transfer, one that is not in the public interest but rather in the interest of a narrow voting bloc. That risk, in turn, goes to the heart of the takings principle, which holds that "public burdens" must be borne by "the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). It is, in short, a risk that justifies enhanced scrutiny and, as the Ninth Circuit rightly determined, just compensation.

The risk that rent-control regulation will disguise naked, rent-seeking wealth transfers is amply illustrated by *Yee v. City of Escondido*, 503 U.S. 519 (1992).[11] In *Yee*, the Court was presented with the "unusual" economic relationship (*id.* at 526) at the heart of the mobile home industry. Most

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[11] Petitioners in *Yee* did not raise, and the Court did not consider, the question whether the regulation violated the regulatory taking line of cases.

"mobile home" owners do not hold title to the land on which their homes are located; rather, they rent land for their homes ("mobile home pads") in so-called mobile home parks. *Id.* at 523. The lease carries a risk of exploitation by the landlord because, once a home is situated on a "pad," the cost of moving it is high relative to its value. *Id.* It is, in other words, *im*mobile. Because the renter must typically sell or abandon the unit upon moving, relocation typically results in a forced sale to the park owner, the only plausible buyer. The landlord is therefore situated to acquire the lessee's property at a cut-rate price.

The risk of exploitation might, in theory, be countered by the terms of the initial lease, which could specify a price formula when the mobile home owner wants to sell. Indeed, courts might sensibly imply a default rule that reaches this result where the lease agreement is silent. In *Yee*, however, the City of Escondido, took more drastic measures. It passed two complementary ordinances putatively designed to protect the renters.[12] These ordinances, however, were highly objectionable because in practice they accomplished a thorough-going, if disguised, expropriation of the landowners' proprietary interests. They extended the duration of the tenant's estate by limiting the landowners' power to evict. *See, e.g.*, Cal. Civ. Code § 798.73. They allowed the tenant to transfer the leasehold interest to a buyer that he alone could select. *Id.* §§ 798.72, 798.74. The landlord, in turn, was relegated to receiving a fixed rate of return stipulated by the legislature. 503 U.S. at 524. His

[12] The first, the Mobilehome Residency Law (Cal. Civ. Code §§ 798-799.51 (West 1982 & Supp. 1992)), limited the grounds on which the renter's lease could be terminated. Crucially, the law prohibited the landowner from restricting the ability of the renter to sublease his property during the life of the rental agreement. *Yee*, 503 U.S. at 524. The second ordinance was a local proposition, Proposition K, which imposed a tight rent control regime and permitted increase only with the approval of Escondido City Council. *Id.* at 524-25.

position was converted, in effect, from that of an owner to that of a creditor—at least if the market rose. If the value went down, the landlord continued to bear the loss. Moreover, the tenant was entitled to *sell* his interest in the property for a price. And, in turn, he received payment from the incoming tenant that equaled, in discounted present value, the same amount that the landlord would have received if the ordinance had never been passed. *Id.* at 527. In this situation, Judge Kozinski, assessing parallel mobile home regulations in Santa Barbara, said "it would be difficult to say that the ordinance does not transfer an interest in the [landowners'] land to others." *Hall v. City of Santa Barbara*, 833 F.2d 1270, 1277 (9th Cir. 1986).

This Escondido mobile home ordinance was not only confiscatory: It was also the undistilled product of raw political pandering. As William Fischel has demonstrated, mobile home-owners in Escondido were conservative, white Republicans, who went to the polls in droves, easily swamping the feeble opposition of park owners. They lobbied the city council heavily for the proposed regulations. And in a Republican locality, their clout carried the day. *See, e.g.*, William Fischel, *Regulatory Takings: Law, Economics, and Politics* 324 (Cambridge 1995) (discussing the political landscape in *Yee*). In effect, the renters had, under the disguise of "rent control," dispossessed the landowners through pure majoritarian muscle-flexing.

The disguised wealth transfer that took place in *Yee* and *Hall* is not an isolated problem: It is an inherent by-product of the political economy of rent control. Rent control ordinances permit wealth transfer from landlords to lessees to be achieved "off budget," immunizing the transfer from normal democratic oversight. In *Pennell v. City of San Jose*, 485 U.S. 1 (1988), for example, the City of San Jose imposed special limits on the power of landlords to raise the rent of "hardship tenants" (described as tenants making less than $32,400 a year). *Id.* at 23 n. (Scalia, J., dissenting). As Justice Scalia's dissent pointedly noted, that subsidy to leaseholders would have been unlikely to gain political

support if it had not been packaged as "rent-control." It was clear that the local citizens were not prepared to pay a rent supplement to these hardship tenants out of their own pockets. *Id.* at 22-23 (Scalia, J., dissenting) (noting it was just not in the cards to think that "citizens of San Jose would allow funds in the municipal treasury, from wherever derived, to be distributed to a family of four with income as high as $32,400 a year").

Together, *Yee* and Justice Scalia's dissection of the political economy of rent control raise cause for concern here. An out-of-state landlord, Chevron, has been forced to submit to a price control scheme that resembles the corrupt bargain at the heart of *Yee*. Chevron must acquiesce to tenants' possession of its property at a controlled price. The incumbent tenants are in turn granted the chance to contract with sub-tenants without the same rent restrictions, thereby recouping the premium Chevron has been denied. Indeed, in several respects, the scheme is worse than that analyzed in *Yee*, since it restricts Chevron's ability to take permanent possession of its property at the expiration of a lease (the necessary result of both the mandated "three year term" imposed on existing leases and the parallel prohibition on landlords' conversion of leased gas stations into company-run gas stations.) Pet. App. 2-3. Because this necessarily limits Chevron's ability to displace under-performing tenants, it amounts to a compulsory entrenchment of local labor, in which service arrangements with local distributors are effectively forced on a disfavored competitor. Making matters even worse, the asserted problem addressed by this regulation (the risk of future anticompetitive conduct resulting from oil companies' vertical integration in the retail market) is both unproven and, indeed, wholly speculative. The reality on the ground is simple, and troubling: A mere incantation of unproven "concentrated" market power among the landlord oil companies papers over the utter lack of record evidence that might assure accountability and protect against political pandering.

To be sure, there are some differences between the rent-seeking schemes described above and Act 257. Chief among them is that the landlord in *Yee* and *Hall* had no opportunity to recoup the losses imposed by the rent regulations. That is not true in this case because the landlords might recoup some of their lost rentals by charging higher prices for the goods and services (such as gas) that they sell to their tenants. As the Ninth Circuit noted, 363 F.3d at 855-57, the district court resolved a battle of two economic experts (John Umbeck, for Chevron, and Keith Leffler, for the state) over the economic consequences of the statute. Professor Umbeck took the position that the decrease in the rents would lead the landlords to increase the price of other products, which would be passed on to consumers. *Id.* at 856-57. Professor Leffler took the position that the prices to consumers would be lowered in virtue of the fact that the statute maintained an independent set of dealers. *Id.* at 857.

We regard this economic debate as largely inconclusive and wholly beside the point. First, we think it inconceivable that any restriction on the ability of the landlords to raise their rents would cause a wholesale price increase that would not have occurred otherwise. If the landlord oil companies had freedom to alter their prices, they would have done so prior to the Act's passage; otherwise, by leaving money on the table they would not have acted as profit maximizers. Professor Umbeck's testimony therefore is not credible. But neither is Professor Leffler's, because, in his desire to show that consumers will benefit from this situation, he ignores the obvious fact that the chief beneficiaries of (and chief lobbyists for) Act 257 are the incumbent tenants (the dealers) who will continue to charge what the market will bear. He does not explain, moreover, why entrenching these dealers in their current position will help consumers; to the contrary, the opposite inference seems the logical one, since entrenchment reduces the ability of Chevron to replace inefficient dealers with company-managed dealers. In the end, the record suggests, strongly, that the Act introduces a gratuitous set of complications for no apparent public

purpose. It allows the local dealers to hide behind the ostensible interests of the consumers for whose welfare they are supremely indifferent.

If, contrary to the dictates of economic theory, the aid given to the tenants somehow advances the public interest, it should be treated like a public function and discharged from general revenues, not inflicted upon landlords *sub rosa*. Rent control, after all, is expensive, and public financing would force those who impose the system to bear its costs. We might then get an honest revelation of the intensity of public preferences. In other words, application of the just compensation principle here would facilitate political deliberation and make transparent the benefits and costs of government regulation. If this increased transparency and political accountability reduces the frequency and extent of a subsidy—that should count as a benefit, and not a disadvantage, of judicial review.

C. Hawaii's Act 257 Constitutes A *Per Se* Violation Of The Takings Clause Because It Effects A "Physical" Taking.

While we think that the analysis offered by the court of appeals was correct in its result, it is nonetheless defective for a very fundamental reason. It does not examine how the distinction between "regulatory" and "physical" takings plays out in the context of rent control. Examined closely, it is apparent that this distinction, applied to rent control regimes, is unsound: Rent control is a paradigmatic physical taking and must be analyzed as such.

1. The "regulatory"/"physical" distinction, applied to rent-control, is untenable. A statute that compels transfer of the possession and the use of the landlord's property to the tenant is plainly a physical taking of a property interest in both an ordinary, and legal, sense of the term "taking"; only precious rhetorical slight-of-hand allows otherwise.[13]

[13] Indeed, as a preliminary matter, all "sticks" within the "bundle" of property rights should be treated as having equal dignity. Nonetheless, for our purposes here, we shall assume that any restriction on the use of property is subject to a lower level of scrutiny than a system in which the owner of property is required to forfeit his right to exclude. *Contrast Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978), *with Kaiser Aetna v. United States*, 444 U.S. 164 (1979).

Under ordinary leases, the property reverts to the landlord at the end of term. However, most rent control statutes, including Act 257, prevent that from happening and thus exclude the landlord from possession. *See, e.g.*, Pet. App. 3 (providing that "renewal" of all existing francishes "shall not be scheduled more frequently than once every three years"); *id.* at 2-3 (barring landlord from converting rented, tenant-operated gas stations into company held, company-operated property at the expiration of the term). Just that result was viewed as a physical taking in the case of the holder of a reversionary interest in a determinable fee simple, *see Preseault v. United States*, 100 F.3d 1525, 1540 (Fed. Cir. 1996) (discussed *infra*). There is no reason why the reversionary interest of a term of years at issue here should be treated in a different fashion.

Indeed, the conception of property as a bundle of rights in a discrete thing, familiar to all students of the common law of property, is wholly disregarded in the rent-control context. To see why, consider the constituent protected interests of a fee simple absolute. A lease, like a life estate and a mortgage, is one of the limited estates that can be carved out of a fee simple. It is an ordinary property interest—in fact, one of the older estates in land. The lease differs from the fee simple in that it is always created by grant or devise, and never acquired by initial or adverse possession. The leasehold interest is therefore born of the contract and conveyance that gives shape to its terms.

For most leases, differences in contract rights are significant. For example, the contract will specify duration, renewal options, assignability, and the duties on each side. In a world without rent control, the parties regulate some of these questions by express agreement; others are regulated by

the set of default provisions created by law. The rent, like the price in a contract of sale, is one term that is almost always set by agreement, without which an executory contract for a future lease is too indefinite to be enforced.

Rent control statutes typically operate to take part of the landlord's interest in his reversion and transfer it to the tenant. In the typical case, they do so by compelling the landlord, usually in the context of a lease renewal, to convey an additional term of years for the benefit of the tenant, at a price determined by the state (typically though a specific administrative board or housing court established for the purpose.) That renewed term of years is an interest in property, whether definite or indefinite, just like the original lease. Its transfer deprives the landlord of the immediate right to possession that was reserved in the original conveyance. It is surely a transfer from landlord to tenant. Thus, there is a "taking of private property" in the sense of its physical occupation, both for the student of ordinary English and the expert in law. The tenant sits: the landlord, as noted, cannot remove him. He is reduced in status, in effect, to a leasehold creditor of property—even though legally he still owns that property.

In response, it may be said that rent control statutes differ from the ordinary taking of property because the state does not retain possession but directs by ordinance that the tenant use it for his own enjoyment. This distinction, however, is spurious; indeed, it renders the state scheme additionally suspect. As noted earlier, the public use limitation prevents taking property from A and giving it to B. Rent control, by contrast, operates as a constructive re-conveyance of the property from the state to the tenant in possession. This constructive reconveyance, in turn, makes the confiscation more politically palatable since a statute providing for naked transfer of possession could not of course be passed. In effect, the rent control statute employs arid legal formalism as a wedge for evasion of the political checks that the Takings Clause is designed to promote.

Here, the property interests at stake in Hawaii's challenged ordinance are indistinguishable from those in the ordinary rent control scheme described above. The statute compels the landlord or company to agree to a three year term for renewal and, in the context of renewal, prescribes the price of the rent. *See* Pet. App. 3. It permits the tenants to sublet without a corresponding price restraint. *Id.* at 4. Finally, it bars the landlord from converting a tenant-run station into a company-run station, limiting (if not extinguishing) the landlord's power to take possession at the end of the lease, and in many cases effectively forcing him to deal with existing tenants. His reversionary interest (consisting of his ability to re-possess at the end of the agreed term and to capitalize on his lease agreement during the term) is partially extinguished. The expropriation of that interest is even more explicit under Act 257 than in the typical rent-control statute, because the Act, by permitting unrestricted sub-leasing, gives the tenant a statutory interest that corresponds to the extra money that the landlord, as the holder of the reversionary interest, would have earned absent his dispossession.[14]

In short, Act 257, like any ordinary rent-control scheme, confiscates the landlord's reversionary interests. It is a "taking" of "property" (U.S. Const. amend. V), pure and simple.

2. The distinction between "physical" occupation and "regulatory" takings, applied to rent control, is not only

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[14] For this reason, many rent-control statutes ban sub-letting. *See, e.g.*, Robert Nozick, *Anarchy, State and Utopia* 270-71 (1974) ("So why do people find the subletting-allowed scheme unacceptable? Its defect is that it makes explicit the partial expropriation of the owner. Why should the renter of the apartment get the extra money upon the apartment's being sublet, rather than the owner of the building? It is easer to ignore the question of why he should get the subsidy given him by the rent-control law, rather than this value's going to the owner of the building.").

analytically difficult to sustain; it has eroded outside the realm of rent-control. The first point of departure is *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). In that case, the petitioner invoked the Takings Clause to bar the New York City government from installing telecommunication wires and switchboxes on his property without his consent. *Id.* at 423. The invasion was trivial in the extreme; it hardly constituted a complete "occupation" of the property. Even so the Supreme Court held that a permanent physical invasion had been effectuated and that the city therefore had to compensate the property owner. *Id.* at 438.

Rent control is far more invasive, since every rent control statute effectuates a forced and complete occupation of the landlord's premises by an unwanted tenant. Consider, for example, Section 3(a) of Act 257; it provides that an oil company cannot convert a rent-controlled dealer station into a company-run station. Pet. App. 2. That condition—the limitation on the landlord's ability to take possession of his property—forces the landlord to permit tenants to occupy the property against the landlord's will. That "physical invasion" is orders of magnitude more severe than the *de minimis* invasion struck down in *Loretto*.

The second point of departure is *Kaiser Aetna v. United States*, 444 U.S. 164 (1979), where the Court recognized that the Takings Clause requires compensation when the state displaces (1) the landlord's present right to control entry to his property and (2) the landlord's right to future use. *Id.* at 178. In *Kaiser*, owners of a Hawaii fishing pond sought compensation after the Army Corps of Engineers attempted to limit their ability to develop the pond as a private marina. The Corp argued that the pond, linked to navigable water by a small channel, was subject to the Rivers and Harbors Appropriation Act of 1899, 33 U.S.C. § 403, which regulates navigable water within U.S. territory and mandates that the owner allow public entry to the waterway. *Kaiser Aetna*, 444 U.S. at 168. The Court upheld federal power to regulate navigation within the pond, since it was connected to a

navigable waterway under federal control. *Id.* at 179. But it nonetheless held that "the Government must condemn and pay [compensation] before it takes over the management of the landowner's property." *Id.*

Kaiser illustrates that the government compromises the rights of exclusive possession even when the only thing it does is allow third parties to enter the property of the landlord. *Id.* (restrictions resulted in "actual physical invasion" by third parties). Here, the decision to allow the independent dealers to remain in possession amounts to the government's reconveying the taken reversionary interest to the sitting tenant. Accordingly, it raises serious public use problems. Yet, even if that taking is sustained under *Midkiff*, full compensation, *i.e.* the fair market value of the property, is required after the regulation is in place.

Finally, in *Preseault v. United States*, 100 F.3d 1525 (Fed. Cir. 1996) ("*Preseault III*"), the Federal Circuit, relying in part on the express direction of this Court, forthrightly recognized that a reversionary interest in a determinable fee is a property right that may be physically taken, for which just compensation is required. *Preseault* involved railroad rights-of-way: turn-of-the century forced easements that had been imposed by the government during the development of rail transportation. *See Preseault v. Interstate Commerce Comm'n*, 853 F.2d 145, 147 (2d Cir. 1988) ("*Preseault I*"). These easements expired when railroad use was abandoned; in many cases they reverted to adjacent landowners under the relevant state common law of property. *Id.* To defeat such reversions, and preserve railroad rights-of-way for future use, Congress passed an act that (1) converted these easements into "biking and hiking trails" and (2) purported to preempt state property law to the extent it provided for the easements to revert to adjacent owners. *Id.* (citing 16 U.S.C. § 1247(d) (1983)).

Petitioners, who lived next to one of the expired rights-of-way, filed a takings challenge to enforce their reversionary rights under Vermont property law. In the first wave of

litigation, the case was appealed to this Court, which remanded for further determination of Vermont law. *See Preseault v. Interstate Commerce Comm'n*, 494 U.S. 1, 16 (1990) ("*Preseault II*"). In the course of its opinion, however, the Court acknowledged that the reversionary interest may constitute a property right protected under the Takings Clause. *See id.* at 16 (suggesting that "some rail-to-trail conversions will amount to takings"). Justice O'Connor, concurring, put the matter emphatically: "Although the [government's] actions may pre-empt the operation and effect of certain state laws, those actions do not displace state law as the traditional source of the real property interests. . . . Any other conclusion would . . . pre-empt the rights guaranteed by state property law, a result incompatible with the Fifth Amendment." *Id.* at 22 (O'Connor, J., concurring).

After further proceedings, the Federal Circuit, sitting *en banc*, ruled in favor of the property owners. First, said the court, the property owners' reversionary interest is "uniformly treated at common law as a vested estate in fee" (*Preseault III*, 100 F.3d at 1534). Second, the taking was "physical" because it ousted the owner of his reversionary right to possession and transferred that interest to the current possessor, the government. *Id.* at 1538 (terming the case one of "physical occupation"). Third, that physical invasion must be accompanied by compensation: "[I]f the Preseaults have interests under state property law that have traditionally been recognized and protected from governmental expropriation, and if, over their objection, the Government chooses to occupy or otherwise acquire those interests, the Fifth Amendment compels compensation." *Id.* at 1550.

The Federal Circuit, notably, rejected the government's argument that state property rights must be interpreted against the background "expectation" of regulatory interference, as the "regulatory taking" line of cases would require. To the contrary, ruled the court:

> [A] physical occupation of one's property by the Government, *that is, a taking of a recognized property interest*, invokes a general expectation of compensation. The Government's reading reverses the sentences, standing the law on its head. They read it to say that an owner's subjective expectations of keeping or losing her property under various possible [regulatory] scenarios define for that owner the extent of her title. Just the reverse is true. It is the law-created right to own private property, recognized and enforced by the Constitution, legislation, and common law, that gives the owner an historically rooted expectation of compensation.

Id. at 1540 (emphasis added).

As *Loretto*, *Kaiser Aetna*, and *Preseault* underscore, it is time to put the distinction between "regulatory" rent-control and "physical" interference with vested property interests to rest. Attempts to ignore the obvious vested property interests at stake in rent control regimes are labored and unconvincing; they sit uneasily with the physical takings cases; and they are inconsistent with the baseline common law rights articulated by the states. The distinction is a doctrinal dead-end. [15]

3. Finally, Hawaii should not escape the legal implication of its physical taking by claiming that rent payments are themselves a form of "just compensation."

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[15] It is also, incidentally, an anomalous artifact of the "emergency" World War I-era rent control system, when the federal government, to address the "sudden influx of people to Washington caused by the needs of Government and the war," imposed rent control to avoid "congestion" in Washington, D.C. *Block v. Hirsh*, 256 U.S. 135, 157 (1921). Those controls were hastily upheld based not only on an immature takings law but on a poor understanding of the economics of rent regulation. *Cf.* Milton Friedman & George Stigler, *Roofs or Ceilings, the Current Housing Problem*, in *Rent Control: Myths and Realities* 87 (The Fraser Inst. ed. 1981) (discussing the flawed economic reasoning underpinning World War II-era rent control statutes).

This should be obvious: Every rent control statute has only one *raison d'etre*—to ensure that the landlord's rent is kept below the fair market rental value of the property. While Hawaii insists its rent control formula is sound, it does so on the assumption that all the appreciation in the value of the property is fair game for the state. Indeed, on its deferential view, the rental rollback need not be limited by this, or any other, formula. As a result, its constant harping on the importance of deference invites the state to cut rents more and more—so long as Chevron has enough money to pay for its ground lease. The more prudent that Chevron is in its own affairs, the earlier it acquired its property, and the more financially sound its operations, then the greater its vulnerability to political manipulation if the state has its way.[16]

The just compensation requirement has bite only if this Court requires measurement of the difference between the market value of the rental prior to, and after, regulation. Thus, the "just compensation" inquiry asks this pointed question: has the landlord been supplied with an equivalent in value to the lost property interest, so that he or she is indifferent between retaining the leasehold interest and the substitute compensation? In other words, if the state evicted A from a $100,000 house, it could not satisfy its constitutional obligation merely by paying A $60,000 in exchange; it would still owe $40,000 for the dispossession. Similarly, Hawaii cannot survive scrutiny when it forces oil companies to accept lower rents than the going market rates. Indeed, the state's improper delegation to tenants of its own duty to compensate imposes an additional risk—the lessee's insolvency—on the landlord, on top of the reduction of his property value. Rent control statutes, quite bluntly, never provide just compensation to the landlord.

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[16] *Compare United States v. Aluminum Co. of Am.*, 148 F.2d 416, 430 (2d Cir. 1945) ("The successful competitor, having been urged to compete, must not be turned upon when he wins.") (Hand, J.).

The irony here is that, in the long run, the system of regulated rents enacted by Hawaii works against the asserted interest of the statutory scheme: the prevention of the (as yet unproven) risk of future vertical integration by large out-of-state leaseholding corporations. If Act 257 is upheld, one out-of-state landlord—Chevron—who has agreed to allow tenants in possession now faces the risk (1) that its tenants cannot be evicted at the end of the lease, and (2) that its tenants, while in possession, will pay a rent equal to a fraction of the property's market value. The fate of Chevron may well convince other out-of-state corporations that maintain a similar system of independent franchisees to invest in Hawaii only through vertically integrated systems (if they invest at all). If so, the Act may well increase the concentrated power of out-of-state corporations at the expense of local residents[17]—rendering, perversely, Hawaii's flagrant violation of constitutional norms as quixotic as it is illegal.

CONCLUSION

Once the correct framework is understood, this case is easy, whether brought under the Due Process or the Takings Clause. The restrictions on rent unquestionably harm the oil companies on whom they are imposed. That harm demands either justification or compensation. Of justification there is none, for this case involves neither physical externalities between neighbors nor an abuse of monopoly power. The most the state can say is that it has decided to confiscate property today in the off chance that it might protect against some imagined form of abuse tomorrow. That premature interaction could be invoked in any conceivable case; it does not offer a sufficient public reason to deny the oil companies

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[17] *Cf. Fitzgerald v. Chrysler Corp.*, 116 F.3d 225, 228 (7th Cir. 1997) (Posner, J.) (noting that if the RICO "enterprise" requirement were interpreted in a way that exposed corporations to greater liability when using a system of independent distributors, RICO would perversely encourage vertical integration).

compensation for the property interests that have been forcibly taken from them.

For the foregoing reasons, the decision of the U.S. Court of Appeals for the Ninth Circuit should be affirmed.

Respectfully submitted.

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January 2005.

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No. 04-163

In The
Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF
THE STATE OF HAWAII, ET AL.,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

**On Writ Of Certiorari To The
United States Court Of Appeals
For The Ninth Circuit**

BRIEF AMICI CURIAE OF CHARLES W. COUPE, ROBERT NIGEL RICHARDS, JOAN ELIZABETH COUPE, AND JOAN COUPE IN SUPPORT OF RESPONDENT

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QUESTIONS PRESENTED

1. Does a regulation that fails to substantially advance legitimate state interests violate the Public Use requirement of the Fifth Amendment?

2. Does the substantially advance legitimate state interests criterion require scrutiny beyond minimum rationality?

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INTEREST OF AMICI CURIAE

Amici curiae Charles W. Coupe, Robert Nigel Richards, Joan Elizabeth Coupe, and Joan Coupe (Richards Family) respectfully submit this brief in accordance with Supreme Court Rule 37.[1]

The Richards Family has for generations owned private real property on the Big Island of Hawaii that now is being threatened with eminent domain to benefit private developers. The Richards Family filed a brief amici curiae in *Kelo v. City of New London*, No. 04-108 – which is scheduled for oral argument on the same day as the present case – explaining why the exercise of eminent domain in that case must substantially advance a legitimate state interest in order to satisfy the Public Use requirement of the Fifth Amendment. The Richards Family appears as amici in the present case because it represents the other half of that analysis: the "substantially advance" standard is a test of Public Use governing regulatory takings, and enforcing regulations that do not substantially advance a legitimate state interest is no different than allowing the government to abuse eminent domain power.

The Richards Family has borne the cost of preparing this brief because this case is of overwhelming importance to them and other property owners nationwide who suffer

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[1] The parties consented to the filing of amici curiae briefs, and copies of the parties' written consents have been filed with the Clerk of the Court. This brief was not authored in any part by counsel for either party, and no person or entity other than amici curiae and counsel made a monetary contribution toward the preparation or submission of this brief.

takings of property by illegitimate exercises of government power, whether by eminent domain or by regulation.

Amici are also consumers of gasoline, and would be directly affected by Act 257, Haw. Rev. Stat. § 486H-10-4 (1997), the State's feckless attempt to lower consumer gas prices in Hawaii – a geographically distant market with few suppliers – by enacting a law capping the rent gas company lessors may charge their tenants for renting service stations.

As the courts below determined, if Act 257 is not invalidated, Hawaii consumers such as the Richards Family will pay the price by actually paying higher – not lower – prices at the pump. Amici respectfully urge this Court to affirm the courts below.

SUMMARY OF ARGUMENT

Regulations that fail to "substantially advance legitimate state interests" violate the Public Use requirement of the Fifth Amendment.

This conclusion results from an examination of the text of the Takings Clause itself, which contains two substantive limitations: (1) the taking must be for public use and (2) just compensation must be provided. Dual remedies give effect to these limitations: if an action is not for public use it is void, and if just compensation has not been provided, a property owner may compel payment. Review of what uses are "public," and what compensation is "just" is reserved for the courts.

The Fifth Amendment limits more than overt exercises of eminent domain. It is a settled element of this

Court's jurisprudence that a regulation – even one branded as "economic" – violates the Takings Clause if it (1) fails to substantially advance legitimate state interests, or (2) deprives an owner of beneficial use of property. *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980). This regulatory takings standard's two-part foundation parallels the Takings Clause's dual requirements of Public Use and Just Compensation.

The "substantially advance" standard is a test of public use.

This brief sets forth why the "substantially advance" test is a Takings Clause standard and why heightened scrutiny should continue to be utilized to review regulatory actions alleged to violate the Fifth Amendment. Regulatory takings jurisprudence has long recognized the intermediate scrutiny of the substantially advance test requires more than the minimum rationality of due process.

This case presents the Court with the opportunity to clarify that the Public Use Clause limits all government actions impacting private property. Amici urge the Court to reaffirm that unless the government shows that a regulation substantially advances legitimate state interests, it is invalid as an act beyond the limited scope of government's power, in violation of the Takings Clause. The Court of Appeals should be affirmed.

ARGUMENT

I. "SUBSTANTIALLY ADVANCE LEGITIMATE STATE INTERESTS" IS A TEST OF PUBLIC USE

A. The Fifth Amendment's Takings Clause Requires Public Use As Well As Just Compensation

The Takings Clause contains two distinct limitations on government action, requiring both "public use" and "just compensation" –

> . . . nor shall private property be taken for public use, without just compensation.

U.S. Const. amend. V. *See Brown v. Legal Foundation of Washington*, 538 U.S. 216, 232-33 (2003).

The Constitution contains neither a grant of eminent domain power, nor of "police power," only limitations on their exercise, with the proviso that any powers not expressly delegated to the national or state governments "are reserved . . . to the People." U.S. Const. amend. X. Consequently, this Court has long held that an action that takes property is beyond the power of government if it is not for public use. *See Vanhorne's Lessee v. Dorrance*, 2 U.S. (2 Dall.) 304, 310 (C.C.D. Pa. 1795) (legislature has "no authority to make an act, divesting one citizen of his freehold and vesting it in another, even with compensation."); *Thompson v. Consolidated Gas Corp.*, 300 U.S. 55, 80 (1937) (public use is an explicit limit on the power of government to take private property even if justly compensated).

A taking that is not for public use is therefore illegitimate and void. *See, e.g., Hawaii Hous. Authority v. Midkiff*, 467 U.S. 229, 245 (1984) (action that fails public use

requirement serves no legitimate purpose of government and is void).

Determination of whether an action violates the Public Use Clause is a judicial function, and even if review is limited in scope, it is never absolutely immune from judicial scrutiny. *Id.* at 240 ("There is, of course, a role for courts to play in reviewing a legislature's judgment of what constitutes a public use . . ."); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 707 (1999) ("To the extent the city argues that, as a matter of law, its land-use decisions are immune from judicial scrutiny under all circumstances, its position is contrary to settled regulatory takings principles.").

Requiring public use insures that private property owners are not being unfairly forced to contribute their property to someone else's private use, that the public is benefitted, and that the government's purported need for the property is genuine before an individual's fundamental rights are disturbed.

Thus, the *Just Compensation* Clause alone may not, as the State's Questions Presented posit, authorize a court to invalidate regulation that takes property.[2] The Just Compensation Clause, however, as the text of the Fifth Amendment plainly reveals, is only half of the takings calculus. The *Public Use* Clause is the textual support for invalidation of regulatory actions that go "too far."

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[2] Petitioners frame the Questions Presented to suggest this case implicates only the Just Compensation Clause. Respondent, however, did not challenge Act 257 simply for failing to provide just compensation, it sought to invalidate the Act as violation of the *Takings* Clause.

B. Regulatory Takings Doctrine Recognizes The Fifth Amendment Restrains More Than Government's Overt Eminent Domain Power

All exercises of government power, and not only overt exercises of eminent domain, are limited by the public use and Just Compensation requirements. *See, e.g., Brown*, 538 U.S. at 232 (interest on lawyer's trust account regulatory scheme took property but takings satisfied public use requirement); *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 315 (1987) (Fifth Amendment requires *both* invalidation and just compensation remedies for police power regulations that violate Takings Clause); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 425 (1982) (regulation served legitimate public purpose).

"Regulatory taking" is an expression of the notion that government's power to rearrange private property rights operates on a continuum, and when it crosses a line – goes "too far" – either in rationale or effect – it matters not what label the legislature attaches to the exercise of power, what matters is the impact of such action on the fundamental right of property. *See First English*, 482 U.S. at 316 ("While the typical taking occurs when the government acts to condemn property in the exercise of its power of eminent domain, the entire doctrine of inverse condemnation is predicated on the proposition that a taking may occur without such formal proceedings."); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922) (Kohler Act enacted pursuant to state's police power went "too far"); *Kaiser Aetna v. United States*, 444 U.S. 164, 172 (1979) (imposition of a navigational servitude pursuant to the federal commerce power would be an invalid taking); *Babbitt v. Youpee*, 519 U.S. 234, 242-45 (1997) (striki..g down exercise of federal power to regulate Indian trust lands for violating Takings Clause); *Andrus v. Allard*, 444 U.S. 51, 64 & n.21 (1979) (federal power to protect endangered species measured against Takings Clause; "there is no abstract or fixed point at which judicial intervention under the Takings Clause becomes appropriate").[3]

Thus, the Takings Clause is violated when the government restricts property to such an extent that it has effectively attempted to exercise eminent domain, the only differences being the government does not formally invoke the power of eminent domain and does not recognize an obligation to provide compensation.

A regulation fails this Court's two-part Takings Clause test when it either (1) does not substantially advance legitimate state interests, or (2) deprives the owner of all beneficial use of property. *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980).

C. Invalidation For Lack Of Public Use In Eminent Domain Is The Same Remedy For A Regulation That Fails To Substantially Advance Legitimate State Interests

Remedies available under the two tests for a taking by regulation are the same as those available to an owner

[3] Similar analysis is applied to other limitations on government power that protect fundamental rights, and these limitations do not depend on the power the government claims to be exercising. For example, police power regulations are reviewed with strict scrutiny if the regulation is alleged to impact free speech rights, even if the regulation is not affirmative government censorship. *See, e.g., Boos v. Barry*, 485 U.S. 312 (1988) (invalidating law restricting placement of signs within 500 feet of embassy because it was not narrowly tailored).

resisting a taking by eminent domain because the owner of private property facing eminent domain stands in the same position as the owner who asserts that regulation has the same effect. *See Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1017 (1992) (from landowner's point of view overregulation is the same as appropriation).

If a taking is not for public use, it is invalid. *See, e.g., Midkiff*, 467 U.S. at 234-35 (property owner sought injunction and invalidation of state legislation alleged to be in violation of Public Use Clause); *Berman v. Parker*, 348 U.S. 26, 28 (1954) (property owner sought injunction and invalidation of federal legislation alleged to violate Public Use Clause).

Similarly, if a regulation does not substantially advance legitimate state interests, it is invalid and may be enjoined. *See, e.g., Nollan v. California Coastal Comm'n*, 482 U.S. 825, 828-29 (1987) (property owner sought writ of administrative mandamus to invalidate action for violation of Takings Clause); *Dolan v. City of Tigard*, 512 U.S. 374, 387 (1994) (owner sought to compel issuance of permit without unconstitutional conditions attached).[4]

[4] The compensation remedies for eminent domain and regulatory takings are also the same. If property is taken by eminent domain but the compensation provided is not adequate, the owner is entitled to a judicial determination of the just amount. *See, e.g., Backus v. Fort Street Union Depot Co.*, 169 U.S. 557, 573 (1898) (Constitution requires full and adequate compensation); *United States v. 56.564 Acres of Land*, 441 U.S. 506, 513-14 (1979) (fair market value, not replacement cost, measures just compensation). If the owner is denied beneficial use of property by a regulation, she is entitled to just compensation in an action in inverse condemnation and the court establishes the amount due. *See, e.g., San Diego Gas & Elec. Co. v. City of San Diego*, 450 U.S. 621, 638 n.2 (1981) (Brennan, J., dissenting) ("The phrase 'inverse

(Continued on following page)

D. It Matters Little Whether Property Is Taken By Eminent Domain Or Regulation

Having the same textual foundation, eminent domain and regulatory takings jurisprudence cannot be logically or practically separated, particularly since from the property owner's perspective it matters little that in one instance the government is threatening to affirmatively confiscate his property by illegitimate means with compensation, while in the other the threatened confiscation is de facto rather than de jure and no compensation is provided. *See, e.g., Lucas*, 505 U.S. at 1017 (taking by overregulation is the same as appropriation); *Rukab v. City of Jacksonville*, 811 So.2d 727, 733 (Fla. Dist. Ct. App. 2002) ("We see no reason to treat a direct condemnation action differently from an inverse condemnation claim in this context.

This Court has long recognized that regulatory takings are not different in effect from affirmative exercises of the eminent domain power when a property owner is either dispossessed of property for improper reasons, or left with little of value:

condemnation' generally describes a cause of action against a government defendant in which a landowner may recover just compensation for a 'taking' of his property under the Fifth Amendment, even though formal condemnation proceedings in exercise of the sovereign's power of eminent domain have not been instituted by the government entity."); *Palazzolo v. Rhode Island*, 533 U.S. 606, 618 (2001) (property owner sought compensation alleging denial of beneficial use); *Lucas*, 505 U.S. at 1009 (owner conceded regulation was valid and sought only compensation); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 689 (1999) (property owner sought damages under 42 U.S.C. § 1983 for just compensation for deprivation of beneficial use).

> It would be a very curious and unsatisfactory result if in construing [the Takings Clause] it shall be held that if the government refrains from absolute conversion of real property to the use of the public it can destroy its value entirely, can inflict irreparable and permanent injury to any extent, can, in effect, subject it to total destruction without making any compensation, because, in the narrowest sense of that word, it is not taken for the public use.

Pumpelly v. Green Bay & Mississippi Canal Co., 80 U.S. 166, 176-78 (1871).

II. "SUBSTANTIALLY ADVANCE LEGITIMATE STATE INTERESTS" REQUIRES SCRUTINY BEYOND MINIMUM RATIONALITY

A. Takings Clause Analysis Has Long Required More Than Minimum Rationality When Reviewing Regulation Impacting Property

Requiring that regulations "substantially advance legitimate state interests" plainly calls for more scrutiny than minimum rationality to determine whether regulation has gone "too far." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922):

> [O]ur opinions do not establish that these standards are the same as those applied to due process and equal protection claims.

Nollan, 482 U.S. at 834 n.3. *See also Dolan*, 512 U.S. at 391. Heightened scrutiny is required. *Penn Central Trans. Co. v. New York City*, 438 U.S. 104, 127 (1978). In *Penn Central*, the Court held that a regulation is a not taking when it serves "a substantial public purpose." *Id.* at 127

(citing *Goldblatt v. Town of Hempstead*, 369 U.S. 590 (1962)). The Court held it is:

> implicit in *Goldblatt* that a use restriction on real property may constitute a "taking" if not *reasonably necessary to the effectuation of a substantial public purpose* . . . or perhaps if it has an unduly harsh impact upon the owner's use of the property.

Penn Central, 438 U.S. at 127 (emphasis added) (citing *Nectow v. City of Cambridge*, 277 U.S. 183 (1928); *Moore v. City of East Cleveland*, 431 U.S. 494 (1977) (Stevens, J., concurring)). Thus, courts may examine the means used to accomplish important government ends, and the use of "substantial public purpose" rather than "legitimate state interest" is telling, for it demonstrates the textual connection between *Agins*' formulation of the standard and the Public Use Clause.[5]

This Court has continued to examine regulation under this standard for over three-quarters of a century. *First English*, 482 U.S. at 316 ("It has also been established doctrine at least since Justice Holmes' opinion for the Court in [*Mahon*] that '[t]he general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.'") (quoting *Mahon*, 260 U.S. at 415). *See also* R.S. Radford, Of Course *a Land Use Regulation That Fails to Substantially Advance Legitimate State Interests Results in a*

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[5] The Court sometimes uses the language "character of the government action" to examine the means used. *See Kaiser Aetna*, 444 U.S. at 175 (imposition of navigational servitude would violate Takings Clause) (quoting *Penn Central*, 438 U.S. at 124).

Regulatory Taking, 15 Fordham Env. L. Rev. 353 (2004) (detailing origins of substantially advance standard).

Subsequent decisions of this Court repeatedly confirmed the continuing validity of the standard, most recently in *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 535 U.S. 302, 333-34 (2002). Between *Penn Central* and *Tahoe*, the Court invoked the substantially advance test many times. *See, e.g., Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1016 (1992) ("As we have said on numerous occasions, the Fifth Amendment is violated when land-use regulation 'does not substantially advance legitimate state interests'"); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 704 (1999) ("requirement that a regulation substantially advance legitimate public interests"); *Agins*, 447 U.S. at 260 (same).[6]

In *Nollan* and *Dolan*, the substantially advance standard provided the rule of decision, and the Court scrutinized the government's method even though the owner

[6] Unless Petitioners establish an irresistible reason to abandon the substantially advance test, the principle of *stare decisis* compels affirmance, as property owners have relied on the limited protection the test has offered for years. *See State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997) (*stare decisis* promotes evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process) (quoting *Payne v. Tennessee*, 501 U.S. 808, 827 (1991)). *Stare decisis* concerns are "at their acme in cases involving property and contract rights." *State Oil*, 522 U.S. at 20 (citing *Payne*, 501 U.S. at 828). The repeated affirmations of the substantially advance standard by the Court mean something and should not be lightly brushed aside. *Cf. United States v. Gaudin*, 515 U.S. 506, 521 (1995) (*stare decisis* may yield where a prior decision's "underpinnings [have been] eroded, by subsequent decisions of this Court").

retained some beneficial use of the property that was alleged to have been taken. *See Nollan*, 482 U.S. at 834 (when regulatory means did not have essential nexus to legitimate goals, there is a danger that government is leveraging police power in an "out-and-out plan of extortion"); *Dolan*, 512 U.S. at 387 (classifying the coastal commission's attempt to obtain the *Nollan* easement as "gimmickry").

Petitioners dismiss this long line of precedent as a "mistaken transposition of substantive due process doctrine into takings law," Brief for Petitioners at 23, insisting that courts cannot inquire whether regulation substantially advances legitimate state interests if the legislature labels its regulation "economic." According to Petitioners, once branded "economic," regulations are virtually immune from challenge, even where – as here – it is undisputed the regulation does not come close to advancing the goal the legislature established, and in fact has the opposite effect.

B. Regulation Is Not Insulated From Review Simply Because It Is Labeled "Economic"

A government action is not immune from public use review simply because it is labeled an "economic" regulation:

> But simply denominating a governmental measure as a "business regulation" does not immunize it from constitutional challenge on the ground that it violates a provision of the Bill of Rights.
>
> . . .
>
> We see no reasons why the Takings Clause of the Fifth Amendment, as much a part of the Bill of

> Rights and the First Amendment or Fourth Amendment, should be relegated to the status of a poor relation in these comparable circumstances.

Dolan, 512 U.S. at 392 (citing *Marshall v. Barlow's Inc.*, 436 U.S. 307 (1978); *Air Pollution Variance Bd. of Colorado v. Western Alfalfa Corp.*, 416 U.S. 861 (1974); *New York v. Burger*, 482 U.S. 691 (1987); *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of New York*, 447 U.S. 557 (1980)).

It is dangerous to rely on legislative labels, rather than effect, because even clear expressions of the purpose of legislation are often ignored or recast after-the-fact by advocates advancing "plausible" rationales to support the regulation when challenged. *See, e.g., Chevron USA, Inc. v. Bronster*, 363 F.3d 846, 855-56 (9th Cir. 2004) (during litigation the State attempted to change its reason for enacting Act 257 from lowering consumer gas prices to protecting dealers). Creative lawyering, not actual effect, would carry the day and completely swallow up the public use requirement and the regulatory takings doctrine. *Cf. Nollan*, 483 U.S. at 841 ("We view the Fifth Amendment's Property Clause to be more than a pleading requirement, and compliance with it to be more than an exercise in cleverness and imagination.").

One clear example from the case at bar is the State's changing posture on Act 257: as the legislative history reveals, the rent control measure was very plainly enacted in order to lower consumer gas prices. The Hawaii Legislature expressly said so. However, when confronted with the fact that the Act would have the opposite effect, the State altered its supporting rationale, instead arguing it is designed to protect service station lessees from a gas

company oligopoly. *See, e.g.*, Brief for Petitioners at 1-2 ("This case involves a challenge to legislation enacted by the State of Hawaii to forestall the evils of oligopolistic concentration in the retail market for gasoline in this State.").

Now, the State is seeking to dispense addressing such inconsistencies altogether, asking the Court to insulate regulatory actions from any meaningful public use inquiry.

C. Dismissing The Substantially Advance Standard As A Due Process Test Writes Out The Public Use Requirement From The Fifth Amendment

In takings where the property owner alleges the regulation is beyond the power of government, the Public Use Clause calls for the heightened scrutiny of the substantially advance test. *See Nollan*, 483 U.S. at 834-35; *Dolan*, 512 U.S. at 396.

Petitioners assert that the validity of regulation may only be challenged under "substantive" due process standards. *See* Brief for Petitioners at 23-36. This assertion, however, virtually ignores the Public Use Clause and strikes it out of the Fifth Amendment when it is invoked as a limitation on the police power. As the Court reminded in *Dolan*, however, both the Takings Clause as well as the Due Process Clause restrict government power. *Dolan*, 512 U.S. at 384 n.5. Ever since the Court recognized that regulations could violate the Takings Clause, it has applied the substantially advance standard to review the public use of regulation. *Penn Central*, 438 U.S. at 127 (regulation is a "'taking' if not reasonably necessary to the effectuation of a substantial public purpose"). The Public Use Clause empowers courts to inquire into the

government's choice of illegitimate means to accomplish its goals. *Midkiff*, 467 U.S. at 240.

Regulation, like exercises of eminent domain, is subject to public use requirement. *See, e.g., Brown*, 538 U.S. at 232 (regulation satisfied public use requirement). The public use requirement cannot be ignored merely because it is regulation that is effecting the taking and not eminent domain.

Thus, the question in the case at bar is whether it would be a public use for the State to have attempted to exercise eminent domain to condemn the rent premium and turn it over to its lessees in order to reduce consumer gas prices. It is beyond doubt that if this question arose in the context of an eminent domain action, the court would be entitled to make that public use inquiry even if compensation were being provided.

D. Courts May Review The Means Used To Achieve Government's Goals

A strikingly similar scheme is being reviewed by this Court in *Kelo v. City of New London*, No. 04-108, the case set for oral argument on the same day as the case at bar.[7]

[7] Because the issues in *Kelo* and the present case are two halves of the same whole, the Richards Family also submitted an amici brief in *Kelo* explaining why exercises of eminent domain should be reviewed under the substantially advance test for public use. *See* Brief Amici Curiae of Robert Nigel Richards, *et al.* Supporting Petitioners, No. 04-108 (filed Dec. 3, 2004). Other amici agree. *See, e.g.*, Brief Amicus Curiae of Professors David L. Callies, *et al.* in Support of Petitioners, No.04-108 (filed Dec. 3, 2004); Brief of Cascade Policy Institute, *et al.*, as *Amici Curiae* in Support of Petitioners, No. 04-108 (filed Dec. 3, 2004).

In *Kelo*, the property owners are asserting that the government violates the Public Use Clause when it exercises eminent domain to take their property and turn it over to another private user supported only by promises the new owner will make more productive use of it. The public use advanced in that case by the government is that a better economy will result. However, the government has not established that seizing that Mrs. Kelo's home will better the economy.

This Court's public use jurisprudence holds that the requirement is "coterminous with the scope of the sovereign's police powers." *Midkiff*, 467 U.S. at 240. This formulation of public use is less instructive in regulatory takings, however, since "police power" is defined as any regulation not effecting a taking. Thomas W. Merrill, *The Economics of Public Use*, 72 Cornell L. Rev. 61, 70 (1986) ("[T]he outer limit of the police power has traditionally marked the line between non-compensable regulation and compensable takings of property. . . . Legitimately exercised, the police power requires no compensation.").

In undertaking this public use review, courts should not defer to the means used. *Nollan*, 483 U.S. at 834-35 ("Our cases have not elaborated on the standards for determining what constitutes a 'legitimate state interest[,]' [but] they have made clear . . . that a broad range of governmental purposes and regulations satisfy these requirements."); *Dolan*, 512 U.S. at 396 (goals established by government were "commendable"). *See also Del Monte Dunes at Monterey, Ltd.*, 526 U.S. at 706 ("the jury was instructed, in unmistakable terms, that the various purposes asserted by the city were legitimate public interests"); *Hodel v. Irving*, 481 U.S. 704, 712 (1987) ("We agree with

the Government that encouraging the consolidation of Indian lands is a public purpose of high order.").

Nollan and *Dolan* represent two instances where the Court held that a regulation did not substantially advance a legitimate state interest and therefore violated the Takings Clause. In neither case, however, did the Court question the validity of the goal advanced by the government, only the means used to accomplish it. *See, e.g.*, *Dolan*, 512 U.S. at 396 ("The city's goals of reducing flooding hazards and traffic congestion, and providing for public greenways, are laudable, *but there are outer limits to how this may be done.*") (emphasis added).

Here, when the means the State chose to lower gas prices will not result in lower gas prices, but would instead raise them, an owner who is being forced to turn over its property to another for illegitimate reasons must be allowed the opportunity to challenge the regulation and not simply be limited to just compensation. The courts are obligated to scrutinize such actions for more than a minimum of rationality.

Public use criteria restricts regulation to public purposes. If the regulation impacts an individual's fundamental property rights, heightened scrutiny is merited to insure that the democratic process has not broken down and the government has not resorted to improper means to achieve proper goals. *See, e.g.*, *Yee v. City of Escondido*, 503 U.S. 519, 530 (1992) (rent premium triggers heightened scrutiny of government's means); *Nollan*, 482 U.S. at 837 (when no compensation provided and regulation has no

nexus to legitimate government goal, danger exists that regulation is "an out-and-out plan of extortion").[8]

The State's gas station rent control measure is very similar to *Kelo*'s "economic development" taking, and both exercises of government power should be measured against the public use requirement under the same standard. Thus, in *Kelo*, heightened scrutiny will be useful to "smoke out" illegitimate criteria when the condemning authority is using the "suspect tool" of eminent domain

[8] Amici suggest that *Berman* requires first instance deference only to the government's advanced goals, because the means used in that case – condemnation of blighted property with payment of compensation – were substantially related to the interest of alleviating blight. However, even if *Berman* and *Midkiff* involve deference to the means used as well as the goal, that does not undercut the application of heightened scrutiny in regulatory takings. In eminent domain, the just compensation requirement acts as a limitation on the exercise of the power, making the government less likely to choose illegitimate means. Any unwarranted benefits to the government are negated by the compensation it must provide, theoretically resulting in a net gain of zero to both the government and the property owner. But where no compensation is provided, this dynamic vanishes, heightening the danger that the purpose advanced is pretextual, and the government has "forg[otten] that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Mahon*, 260 U.S. at 416. Those cases in which the Court invalidated regulation as a taking for failure to pay just compensation can best be understood as cases in which the public use requirement also was not satisfied because the legitimate government interest was not advanced substantially by a confiscation of property without just compensation. *See, e.g.*, *Loretto*, 458 U.S. at 424 (property owner sought injunctive relief for regulatory taking), *Kaiser Aetna*, 444 U.S. at 176 ("But this is not a case in which the Government recognizes any obligation whatever to condemn 'fast lands' and pay just compensation . . . "); *Nollan*, 482 U.S. at 841-42 (state is free to use power of eminent domain to accomplish the public purpose it attempted to advance by regulation).

supported only by promises of economic development. *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 493 (1989).

A similar rationale supports application of the substantially advance test in the present case. When it attempts to redefine property rights, a legislature not constrained by the just compensation obligation may not choose to accomplish its goal by means having the least profound impact on private property rights, but may target certain individuals unfairly to bear more than their share by effectively confiscating their property with no attendant public benefit. *See Dunn v. Blumstein*, 405 U.S. 330, 343 (1972) (state should take path that lessens burdens on constitutionally protected activity).

This case illustrates this danger. The State is taking Respondent's property and giving it to its lessees in an attempt to lower consumer gas prices. As the lower courts found, this goal will not be accomplished by the regulation. Thus, the "average reciprocity of advantage" rationale that supports the uncompensated exercise of police power does not exist. Chevron is deprived of its property, the lessees are the only parties enriched, and the public sees no benefit at all, and may even be worse off. A regulation loses its public character when it is patently unable to accomplish its purported goal.

E. "Substantive" Due Process Protects Different Interests Than The Takings Clause, And Reaffirmation Of The Substantially Advance Standard Is Not A Return To *Lochner*

Dismissing the substantially advance standard as an orphaned due process test also ignores the different

interests protected by the Takings Clause and the Due Process Clause.

"Substantive" due process protects the right to avoid regulation that intrudes upon extra-textual "liberty" interests. *See, e.g., Poe v. Ullman*, 367 U.S. 497, 516-17 (1961) (Douglas, J., dissenting) (in addition to fair procedures, due process includes the right to travel, the right to marry, and the right to privacy). The Takings Clause protects private property from de jure or de facto appropriation, and requires that any taking be for public use and that compensation is provided. This does not call for a guarantee of "economic liberty" protected under the now discredited *Lochner v. New York*, 198 U.S. 45 (1905) and its progeny. A regulatory takings plaintiff must allege and prove that she has a legitimate claim of entitlement to property, *see Board of Regents v. Roth*, 408 U.S. 564 (1972), not merely that she has some unrealized economic expectations that have been thwarted by regulation.

In the eighty-plus years of its existence, judicial scrutiny under the substantially advance standard has not resulted in unwarranted intrusion into legislative functions, or presaged a return to *Lochner*'s theory of economic liberty.

First, heightened scrutiny, as *Nollan* and *Dolan* make clear, applies to the means used by government to achieve its goals. The Court has never hesitated to review police power regulations that impact fundamental constitutional rights with heightened scrutiny. *See, e.g., Ladue v. Gilleo*, 512 U.S. 43 (1994) (invalidating under the First Amendment municipal regulation of residential signs as not closely tailored). Property is a fundamental right. *See Lynch v. Household Finance Corp.*, 504 U.S. 538,

552 (1972) ("The dichotomy between personal liberties and property rights is a false one."); *Dolan*, 512 U.S. at 392 (all fundamental rights deserve constitutional scrutiny).

Second, some regulations will pass even *strict* scrutiny, *see Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 201 (1995) ("we wish to dispel the notion that strict scrutiny is strict in theory, but fatal in fact"), so there is no reason to suspect that the *intermediate* substantially advance level of scrutiny will result in wholesale invalidation of legislation. For example, the regulatory schemes in *Berman* and *Midkiff* would pass substantially advance scrutiny.[5]

Third, the Court addressed the concern of judicial "second-guessing" in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 704 (1999). In that case, a jury found the government's repeated permit denials did not substantially advance a legitimate state interest. *Id.* at 703-04. The city asserted that jury instructions should not have permitted the jury to review its land use determinations. *Id.* at 704 ("[T]he city maintains that the Court of Appeals adopted a legal standard for regulatory takings

[5] The government actions in *Berman* and *Midkiff* pass intermediate scrutiny, because the means chosen by the government – eminent domain with the payment of just compensation – were substantially related to the advanced goals. In *Berman*, the regulation was designed to improve severely blighted property in Washington, D.C. *Berman*, 348 U.S. at 30. In *Midkiff*, the Hawaii Land Reform Act was enacted to remedy the ills perceived to be caused by concentrated land ownership. *Midkiff*, 467 U.S. at 232-33, 241-42. The Court did not question that eliminating blight and the breakup of land oligopolies are legitimate government goals. The means used in the cases substantially advanced those ends: taking blighted property by eminent domain and putting it into the hands of a redeveloper alleviated the blight; exercising eminent domain to vest individual owners with title diversified ownership.

liability that allows juries to second-guess public land-use policy."). The Court noted first that the jury charge was "consistent with our previous general discussions of regulatory takings liability," *id.*, then rejected the city's argument that the substantially advance standard opened up legislative determinations to judicial scrutiny.

CONCLUSION

Textually rooted in the Public Use Clause, the "substantially advance" takings requirement cannot be lightly brushed aside or simply subsumed within "substantive" due process analysis. The Fifth Amendment contains independent limitations on government power, which requires that regulations satisfy public use standards, not simply that the government provide compensation if the regulation impacts property's value.

In the end this case, like *Kelo*, is reduced to this vital fact: the Constitution contains the *Public Use* Clause, not just the Just Compensation Clause.

The Court of Appeals should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and
MARK J. BENNETT, Attorney General of the State of Hawaii,
Petitioners,

v.

CHEVRON USA, INC.,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit**

BRIEF *AMICI CURIAE* OF EQUITY LIFESTYLE PROPERTIES, INC., CALIFORNIA MOBILEHOME PARKOWNERS ALLIANCE, THE MANUFACTURED HOUSING EDUCATIONAL TRUST OF ORANGE, RIVERSIDE AND SAN BERNARDINO COUNTIES, MANUFACTURED HOUSING EDUCATIONAL TRUST OF SANTA CLARA COUNTY, AND SEVERAL DISTINGUISHED PROFESSORS OF ECONOMICS IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI CURIAE*[1]

Each of the *amici* has a strong interest in a central issue in this case: namely, whether a state restriction on rents for real property must "substantially advance" a legitimate state interest. In particular, *amici* have an interest in rent control restrictions that give rise to a "premium" in mobile home communities. Such a premium exists when the existing tenant of a mobile home plot is able to capitalize and transfer the economic benefits of the rent control regulation to a subsequent lessee, thereby appropriating the supposed public benefit of the rent control restriction. Whether such a rent control restriction violates the Takings Clause was at issue (but not decided) in *Yee v. City of Escondido*, 503 U.S. 519 (1992). The ultimate resolution of that issue may be affected by the constitutional standard adopted by the Court in the instant case.

Equity Lifestyle Properties ("ELS") is the largest owner of properties focused on serving the housing needs of retirees, seasonal and second home-owners, and recreational vehicle owners in the country, with a controlling interest in 270 communities located in 25 states and representing over 100,000 sites. ELS rents its sites to owners of factory-built housing, including manufactured homes, park models, and mobile homes. ELS is a publicly traded real estate investment trust (REIT) that must distribute over 90% of its income annually to its shareholders. ELS shareholders include pension funds, retirees, and other individuals who depend upon income from these investments. ELS has a fiduciary duty to its shareholders to maximize the value of their investment in ELS by charging rents that reflect the value of the real estate in which ELS has invested on their behalf. ELS

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[1] All parties have consented to the filing of this *amicus curiae* brief. No portion of the brief was authored by counsel for a party. No person or entity other than the *amici* signing this brief or their counsel made a monetary contribution to the preparation or submission of the brief.

has over 20 properties in California, of which 13 (representing over 3,700 sites) are currently subject to rent control ordinances. These rent control ordinances limit annual rental increases to the annual increase in the CPI or a fraction thereof – or, in some cases, to no increase at all. ELS estimates that, if these ordinances are constitutional, hundreds of millions of dollars of value will have been taken from its shareholders and transferred to the residents in these communities. ELS has initiated litigation in at least five California jurisdictions challenging their rent control ordinances.

California Mobilehome Parkowners Alliance ("CMPA") is the second largest state-wide association of park owners, dealers, and service and industry representatives. CMPA has been representing the manufactured housing industry for over 15 years. It advocates on behalf of service and industry members and owners of communities consisting of tens of thousands of home sites in numerous mobile home parks in California.

The Manufactured Housing Educational Trust of Orange, Riverside and San Bernardino Counties ("MHET") was incorporated in 1982 as a non-profit trade association representing the owners of mobile home and manufactured housing communities in the Southern California counties of Orange, Riverside, and San Bernardino. There are over 840 mobile home parks and manufactured housing communities in this tri-county area. MHET is dedicated to promoting the manufactured housing and mobile home business industry and to educating manufactured and mobile home owners, community leaders, and the public about manufactured housing community and mobile park issues.

Manufactured Housing Educational Trust of Santa Clara County ("Santa Clara MHET") is a separate association representing the owners of mobile home and manufactured housing communities within Santa Clara County, California. There are a large number of manufactured home communities

in the county, notably located in San Jose (more than 10,000 sites in almost 60 properties), Sunnyvale (almost 4,000 sites in 14 properties), and Mountain View (about 1,800 sites in six communities).

John Quigley is the I. Donald Turner Professor of Affordable Housing and Urban Policy at the University of California, Berkeley. He is Professor of Economics and Public Policy at Berkeley, and he directs the Berkeley Program on Housing and Urban Policy. Edward Glaeser is a Professor of Economics in the Faculty of Arts and Sciences at Harvard University. He is the director of the Taubman Center for State and Local Government and the director of the Rappaport Institute of Greater Boston. Robert Edelstein is a Professor of Business Administration at the Walter A. Haas School of Business at the University of California, Berkeley. He is also Co-Chair of University of California, Berkeley's Fisher Center for Real Estate and Urban Economics. Yongheng Deng is an Associate Professor of Policy, Planning and Development at the University of Southern California, and Research Fellow at the University of Southern California's Lusk Center for Real Estate. He has served as an Economist and Expert at the Office of Federal Housing Enterprise Oversight. Each of these distinguished economists has focused his research and scholarship on real estate finance and housing policy.

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioner and the United States contend that the Ninth Circuit erred in holding that a state restriction on rents for real property must substantially advance a legitimate state interest. In *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), this Court stated that "[w]e have long recognized that land-use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests' and does not 'den[y] an owner economically viable use of his land.'" *Id.* at 834 (quoting *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980)). In *Yee v. City of Escondido*, 503 U.S. 519, 523 (1992), the

Court similarly explained that whether a rent regulation constituted a regulatory taking depended upon consideration of the purpose of the regulation and whether circumstances "suggest that the regulation has unfairly singled out the property owner to bear a burden that should be borne by the public as a whole."

The decision in *Yee* arose in the context of mobile home rent control.[2] Specifically, the Court recognized that consideration of whether a rent control ordinance creates a premium transferable by the tenant – that is, a capitalization of the economic benefits of the rent control regulation – "might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* at 530. The Court in *Yee* did not decide the issue, however, because it was not fully presented.

In launching a broad assault on the requirement, recognized in *Nollan* and other cases, that a permissible regulatory taking of property must "substantially advance legitimate state interests," Petitioner and the United States seek a ruling that would have implications far beyond the Hawaii statute at issue here. Among other things, the ruling sought could affect the mobile home rent control issue discussed by this Court in *Yee*, by the Ninth Circuit in *Cashman v. City of Cotati*, 374 F.3d 887 (9th Cir. 2004), and by other lower federal and state courts. The purpose of this *amicus* brief is to show, using the related context of mobile home rent control, that it is indeed appropriate to require that, where a regulatory rent restriction on real property may give rise to a premium, such rent

[2] The owner of a mobile home rents a plot of land or "pad" from the property owner. The mobile home owner has special rights with respect to the park owner; the park owner is expected to provide "private roads within the park, common facilities such as washing machines or a swimming pool, and often utilities." *Yee*, 503 U.S. at 523.

restriction must substantially advance a legitimate state interest.

Mobile home rent control often is enacted on the basis of an asserted government interest in increasing the supply of affordable housing. It is firmly established that it has precisely the opposite effect. Economists broadly recognize that, when a rent-controlled leasehold is transferred for a premium, the putative benefits of the regulation are illusory. The existence of a premium means that a new tenant – the purported beneficiary of the regulation – must purchase the supposed benefits of the rent control regulation, likely at their full present discounted value. Thus, the property owners' interest in real estate, which should be captured by such property owner in the form of rent, is transferred to tenants in the form of a premium with the sale of a tenant's home. In that circumstance, the regulation will not confer a benefit on the public or bear a reasonable nexus to a public purpose. In fact, when rent control benefits can be capitalized, access to below-market housing is denied to those who need it most – *i.e.*, those with limited capital or access to capital, who can least afford to purchase or finance the cost of the premium. The effect of such a rent control ordinance simply is to convey a portion of the value of the real property from the property owner to the tenant in residence at the time the regulation is enacted, without making housing more affordable or otherwise advancing any public purpose. It is functionally equivalent to transferring land from one private owner to another.

As set forth in Part I, the economics of mobile home rent control demonstrate that this Court should reject Petitioner's invitation to eradicate the "substantially advance" standard. Empirical analyses and the record in a number of district court cases demonstrate that mobile homes can have established values of $10,000 or less but can sell for as much as $500,000, because tenants are compelled to purchase the expected, risk-adjusted present value of all future rent control savings with

the home. The record in these cases together with basic economic principles demonstrates that, in particular, California's mobile home rent control has no reasonable relationship to any proffered public purpose, reduces the supply of affordable housing, and makes housing less accessible to those with fewer resources.

Municipalities in California have used the guise of mobile home rent control to transfer hundreds of millions of dollars of real estate value from politically vulnerable landowners to politically powerful local constituents, without promoting a public purpose. *See, e.g.*, John M. Quigley, *Economic Analysis of Mobile Home Rent Control: The Example of San Raphael, California* (Sept. 12, 2002); John M. Quigley, *The Economics of Mobile Home Rent Control in Santee, California* (Mar. 19, 2004); John M. Quigley, *The Economics of Mobile Home Rent Control: A Case Study of Goleta, California* (Aug. 11, 2004). At a minimum, the "substantially advance" standard should continue to apply to circumstances in which rent control regulations may give rise to a premium.

As demonstrated in Part II, this case provides no basis for this Court to revisit its decisions in *Nollan*, *Yee*, and two decades of jurisprudence that establishes that the "substantially advance" standard should apply to regulatory takings. Petitioner's effort to write the "Public Use" clause out of the Property Clause is without basis.

Certainly, in the context of a physical taking, the government does not have the power to take property absent a reasonable nexus to a public purpose, regardless of whether it pays compensation. "To be sure, the Court's cases have repeatedly stated that 'one person's property may not be taken for the benefit of another private person without a justifying public purpose, even though compensation be paid.'" *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 241 (1984) (citations omitted). There is no basis to reach a contrary result in the regulatory taking context. In fact, this Court has repeatedly

recognized that the "Public Use" requirement is equally applicable to regulatory takings.

Petitioner contends that judicial review of the "reasonableness" of regulations under the "substantially advance" standard would return courts to the *Lochner* era. But application of the "substantially advance" standard does not require any policy judgments about the reasonableness or wisdom of legislative decisions. Rather, it focuses the judicial inquiry on a narrow factual question, familiar to judges and juries, whether a regulation actually advances its objective. That standard is a familiar one in the First Amendment context. To ensure that property rights are not taken for purely private purposes, that limited inquiry is vital.

Finally as set forth in Part III, there also is no basis to disturb the Ninth Circuit's application of the "substantially advance" standard in the circumstances presented in *Yee – i.e.*, rent control regulations that may result in a premium. The Ninth Circuit has been careful not to second-guess the validity of legislative purposes or the reasonableness of regulations. The "substantially advance" standard has been appropriately applied by the Ninth Circuit both in the instant case and in the context of mobile home rent control regulations that otherwise would transfer billions of dollars of windfall value to local constituents, without advancing any public purpose.

I. THIS COURT SHOULD TAKE NOTE OF THE EGREGIOUS CONSEQUENCES OF CALIFORNIA'S MOBILE HOME RENT CONTROL IN DETERMINING WHETHER TO APPLY THE "SUBSTANTIALLY ADVANCE" STANDARD TO RENT REGULATIONS THAT MAY GIVE RISE TO A PREMIUM.

This Court's decision in *Yee v. City of Escondido* concerned a particularly draconian form of rent control, California's mobile home rent control. This form of rent control has two unique characteristics. First, as with all mobile home rent

control (but unlike apartment rent control), ownership of the land and the physical structure are separate. Second, under the California Mobilehome Residency Law, Cal. Civ. Code § 798 et seq. (West 1982 and Supp. 1991), a mobile home landlord cannot terminate the tenant's right to occupancy, except for cause. Thus, as this Court recognized in *Yee*, the departing tenant can stay at the property as long as she wants.

These two unique characteristics allow a tenant to sell a mobile home located in place on an existing plot for an amount that includes a premium. Like "key money," the premium represents the discounted value of the future rent savings. Effectively, such regulation licenses the tenant to resell all regulatory benefits associated with the tenant's leasehold, for an amount representing the value of those benefits in perpetuity. In fact, the tenant is receiving value that, in the absence of the regulation, the property owner could charge as rent based upon the market value of the real estate. As discussed below, this unique type of regulation has pernicious effects – it increases the cost and inaccessibility of housing – and cannot reasonably further any purpose other than effecting a one-time transfer of wealth to a private group.

A. Economists Broadly Agree that Rent Control Leads to a Reduction in the Supply of Affordable Housing.

Economists generally believe that all forms of rent control will ultimately reduce the supply of affordable housing. But even if some forms of rent control serve a valid public purpose, California's mobile home rent control does not: any regulatory benefits necessarily will be capitalized and sold at full value. Because mobile homes can be purchased only by those who can afford to purchase these regulatory benefits in a lump sum transaction, access to rent-controlled housing is denied to those who do not have what can be the hundreds of thousands of dollars (or comparable credit) needed to purchase the premium. As a consequence, those most in need of affordable housing will receive no benefit whatsoever. The

only beneficiary is the tenant who happens to be renting the land when the regulation is enacted, who receives a windfall equal to all future rent control savings.

In one case, *MHC Financing Ltd. Partnership v. City of San Rafael*, 00-C-3785 VRW (N.D. Cal.) (under submission pending the outcome of this case), expert testimony was presented by several of the nation's leading economists and experts on affordable housing, including Professor Daniel Fischel, former Dean of the University of Chicago Law School, Professor John Quigley (one of the *amici* here), and Professor Robert Edelstein (also an *amici* here). They demonstrated through empirical analysis that the premium, representing the difference between the selling price of the home and its intrinsic value, simply capitalized any rent savings. Dr. Quigley demonstrated using standard statistical methods that reductions in rents were reflected in substantial increases in monthly housing cost associated with purchasing the mobile home. As discussed below, the consumer is not indifferent to whether the dollar must be paid in the form of rent or in the form of a mortgage cost: those with least access to capital will be unable to finance the purchase of the home.

Although economists disagree on many things, there is clear consensus concerning the effects of rent control: these regulations lead to reductions in the quality and quantity of housing available to consumers. *See* Richard M. Alston, J. Kearl and M. Vaughn, *Is There a Consensus Among Economists in the 1990s?* 82 Am. Econ. Rev. 203-09 (1992). Recent scholarly work (*e.g.*, Bengt Turner and Stephen Malpezzi, *A Review of Empirical Evidence on the Costs and Benefits of Rent Control*, 10 Swedish Econ. Pol'y Rev. 11-56 (2003)) only reinforces the survey of opinions reported by Alston, Kearl, and Vaughn a decade earlier on the effects of rent control:

First, over time, below market rents are typically not distributed to those in need. "Lucky-in-place" residents benefit at the expense of new households and immigrants from

other regions. Kaushik Basu & Patrick M. Emerson, *The Economics of Tenancy and Rent Control*, 110 Econ. J. 939-62 (2000). Below-market rents are not allocated to those who value them the most. *See* Edward L. Glaeser & Erzo F.P. Luttmer, *The Misallocation of Housing Under Rent Control*, 93 Am. Econ. Rev. 1027-46 (2003) (emphasizing that these social costs are quite large because housing is scarce); Edgar O. Olsen & David M. Barton, *The Benefits & Costs of Public Housing in New York City*, 20 J. Pub. Econ. 299-332 (Apr. 1983).

Second, housing suppliers see the economic value of their properties decline, and they react by reducing maintenance expenditures. The incentive to invest capital to produce new housing is inexorably reduced. Reduced supply makes housing more costly for consumers at large. *See* Richard Arnott, *Rent Control*, in The New Palgrave Dictionary of Economics and the Law (1998).

Third, artificially low rents lead to excess demand for housing, to the hoarding of rent-controlled units, and to reduced household mobility. The popular literature is replete with anecdotes describing how rent control leads to housing that is hoarded by those who are not the most in need. *See, e.g.,* Kenneth Auletta, *And the Streets Were Paved with Gold* (1979).

B. Mobile Home Rent Control Is a Unique Form of Rent Control that Does Not Advance Any Legitimate Purpose.

Beyond the social costs inherent in all rent control, mobile home rent control represents a substantially different form of rent control that lacks a reasonable nexus to any public purpose. There are two important differences in the institution of rent control when it is selectively applied to mobile homes. First, there is a divided ownership in mobile home parks: the owner of the mobile home typically owns only the housing

unit and rents a site in a mobile home park on which the home is situated. Second, the rent control regulations are imposed on only a small portion of the local housing market, namely those dwellings in mobile home parks. Prices in the larger housing market are set by supply and demand, not by regulation.

Because of divided ownership, every tenant must pay in full for the benefits that the regulation would otherwise provide. The tied sale of the home together with the right to occupy a below-market site is analytically equivalent to a payment of "key money" in apartment rent control. These tied transactions are invariably illegal under apartment rent control ordinances, but are *inevitable* under mobile home rent control ordinances.

The fact that mobile homes are usually a small portion of the local housing market means that housing prices in the area are set by the forces of supply and demand, and rent control rules have little or no impact on prices in this larger market. Increased demand produces upward pressure on mobile home prices as well as on the prices of condominiums, apartments, and singe-family homes. The right to occupy a site at a below-market rent simply increases in value and will be sold at a premium reflecting the discounted rent savings. And those with the least amount of capital or access to capital will least be able to afford that premium.

C. California's Mobile Home Rent Control is the Paradigm of a Regulation That Confers No Public Benefit.

Mobile home rent control in California is yet an even more egregious institution. California mobile home tenants are granted life estates in the land and the ability to transfer such life estates to a third party, municipalities are unrestrained in their ability to limit rent, and the economic burden often falls on one or two landowners. In fact, California municipalities

have effectively conferred on a fortuitous group of existing tenants the right to sell to the purchaser of their mobile home a) the tenant's own artificially below-market rents; b) a license to receive the benefits of discounted rents for the purchaser's life estate; and c) a license to resell those benefits in perpetuity. Under the guise of selling a mobile home, selling tenants thus compel purchasers of their homes to pay for this bundle of property rights that, absent the regulation, would belong to the property owner.

Some California municipalities have simply frozen rents. Others limit annual increases to a fraction of the increase in the CPI, and the CPI increases at a fraction of the rate of the increase in housing prices in coastal communities. Annual increases at a fraction of the CPI, such as the .75 percent CPI limitation challenged in *MHC Financing Ltd. Partnership v. City of San Rafael*, 00-C-3785 VRW (N.D. Cal.), lead to an exponentially expanding gap between permitted rents and market rents.

If California municipalities are not subject to meaningful constitutional constraint, they will impose draconian rent limitations, setting rents at half the market rent or less, and effectively use the guise of regulation to transfer the value of real property from an often out-of-state owner to a select group of local constituents, without advancing any public purpose.[3]

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[3] The phenomenon of capitalization is well known in real estate markets where the advantages of better schools or lower tax rates are reflected in the selling price of dwellings. *See* Wallace E. Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. Pol. Econ. 957-71 (1969). Similarly favorable contractual terms of assumable mortgages are capitalized in the selling price of single family homes. *See* Dan Durning & John M. Quigley, *On the Distributional Implications of Mortgage Revenue Bonds and Creative Finance*, 38 Nat'l Tax J. 513-24 (1985). There is every reason to expect that any perpetual rent control savings will be fully capitalized in the purchase price and the cost of housing will not be reduced.

While a "legitimate and rational goal of price or rate regulation is the protection of consumer welfare," *Pennell v. City of San Jose*, 485 U.S. 1, 13 (1998), when the benefits of the regulation are fully capitalized there is *no* enhancement of the consumer welfare. Only the initial recipients of the premium are better off. And a one time transfer of wealth from a single landowner to a random group of local beneficiaries does not qualify as a public purpose.

1. Mobile Home Rent Control Makes Housing Less Affordable and Less Accessible.

Requiring a lump sum payment for future rental savings is not economically neutral – it creates a barrier to entry. By capitalizing future rent savings and making housing available only to those who can afford to pay the capitalized cost up front, California's mobile home rent control makes housing less accessible to low-income individuals.

Those on fixed incomes and with poor credit history may be able to pay a particular rent, but will generally be unable to afford a lump sum payment equal to the value of future rent savings. And, because lenders view low-income borrowers as a riskier investment, individuals with low incomes must spend more than those with higher incomes on interest expense in order to gain access to the same amount of capital. As discussed below, these lump sum premiums or barriers to entry are often worth hundreds of thousands of dollars in California. Few low-income individuals can qualify to pay several hundred thousand dollars for a mobile home that otherwise would sell for $10,000 or less.

The practical consequences of this rent control scheme is reflected in the evidentiary record of various cases in which the constitutionality of this scheme has been challenged. In one such case, *Manufactured Home Communities, Inc. v. City of Santa Cruz*, C 00-20630 (JF), the allegations reflect that mobile homes with minimal intrinsic value were selling for as

much as $500,000 – reflecting principally the present value of the perpetual license to use the land at below-market rents.

Mobile home values are reflected in various "blue books" and "cost guides." Many have established resale values of less than $10,000. Certain makes and models pre-date the current HUD codes and are obsolete; these homes generally have only salvage value, if any value at all. However, these obsolete homes are selling in rent control jurisdictions for hundreds of thousands of dollars. It is apparent that what the tenants are selling, along with the *de minimis* value of the home itself, is the value of the license to perpetual rent savings.

In fact, Dr. Quigley has conducted independent analyses of three different California markets in which there is mobile home rent control: San Rafael, Goleta, and San Diego. He found that rent savings were capitalized into increased selling prices for mobile homes. Thus, in each case, the regulation impeded access to affordable housing.

2. Mobile Home Rent Control Does Not Advance Any Other Public Purpose.

Recognizing that mobile home rent control reduces the affordability and accessibility of housing, certain municipalities have now concocted new purported government purposes to rationalize their raw transfer of property rights. Some contend that the regulations serve to preserve a tenant's "equity" in the mobile home. But the only differential in the sale price of a mobile home that is caused by rent control is an artificial premium representing the value of the regulation itself. Yet the value of the regulation is not "equity" that belongs to a tenant. And if later tenants receive more upon resale than they would absent the regulation, that is only because they were forced to pay more, *i.e.*, the premium, when they purchased. There is no net benefit.

Another putative rationale for mobile home rent control is to preclude "unreasonable rent increases." Any reduction in

rents must be purchased in full through the payment of a premium, however, equal to the value of the discounted rents. Compelling the pre-payments of rents in the form of a premium discriminates against and excludes from the market those with the least resources and weakest access to credit. Moreover, mobile homes are part of a broader housing market and thus a mobile home park owner has no ability to extract monopoly or oligopoly prices from renters. There is no mobile home rent control in 48 states and there is no documented record of monopoly pricing in those states.

D. The Conduct of Municipalities in Applying Mobile Home Rent Control Demonstrates that the Democratic Process Will Result in a "Land Grab" by Local Constituents, Absent Meaningful Judicial Review.

Additionally, the record in the California mobile home park cases demonstrates that meaningful judicial review of mobile home park rent control is particularly necessary because of the risk that local legislatures will be unduly subject to local constituent pressures. Politically powerful local interests have actively lobbied local officials to take property from out-of-state owners. If this Court does not protect property rights in these circumstances, those rights can simply be taken by local government for the singular benefit of a discrete group of private constituents.

As but one example, in the San Rafael case, the city reached a settlement agreement in which it agreed to allow rents to be adjusted to market when new tenants moved in. The City Manager publicly acknowledged that the sale price of mobile homes had "skyrocketed as a result of the [rent control] ordinance." However, when the local residents descended upon City Hall, claiming that their homes would sell for hundreds of thousands of dollars less (thereby making housing more affordable) without the ability to resell the benefits of the rent control legislation, the City Council simply refused to abide by its agreement to modify the law. Mobile homes in

that community now sell for ten times their actual value and more.

Absent constitutional constraints and meaningful judicial review, there will be no meaningful limit on the ability of local governments to simply take property and/or much of its value from out-of-state owners and transfer it to a small group of local constituents. The mobile home rent control experience in California shows that this Court has a critical role to play in protecting property rights, because the local political process is beholden to existing residents. And, because there is often only one mobile home park in a municipality, the burden of regulation often falls on a single landowner.

Petitioner offers no reason why this Court should categorically reject the "substantially advance" standard. To the contrary, that standard serves an important function in giving effect to the Public Use clause of the Property Clause.

II. TWO DECADES OF JURISPRUDENCE ESTABLISH THAT THE "SUBSTANTIALLY ADVANCE" STANDARD SHOULD APPLY TO REGULATORY TAKINGS.

This Court has recognized that regulations may deprive a citizen of their private real property in a manner that is comparable to a partial physical taking. *See Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg. Planning Agency*, 535 U.S. 302, 325-26 (2002) (recounting that Justice Holmes' opinion in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922) gave birth to the regulatory taking doctrine by recognizing that protections against physical appropriations of private property would be meaningless if the government could redefine the range of property interests through regulation). Thus, this Court has recognized for over eighty years that, "if [a] regulation goes too far it will be recognized as a taking." *Id.* at 326 (quoting *Pennsylvania Coal*, 260 U.S. at 415).

When a regulation so burdens private real property as to constitute a taking, there must be some judicial scrutiny of

whether the governmental burden on private property actually advances a valid purpose of government – just as there is when the taking is physical. Absent that inquiry, local governments would have unbridled authority to transfer the value of real property from its owners, to favored private constituents, without promoting any legitimate purpose of government.

In the physical taking context, the only issue is whether the use of the land is a public use, *i.e.*, the taking is for a public purpose. If it is, there is no question that dedication of the land to that public purpose will substantially advance the public purpose. By contrast, in the regulatory taking context, it is not sufficient that the purpose is a public purpose. The purpose may be a valid public purpose, such as promoting beach access, but if the regulation has no reasonable nexus to that purpose, the public use requirement is not met. Thus, in the regulatory taking context, there must be a reasonable causal relationship between the regulation's effect and its purpose – it must substantially advance the purpose. If it does not, the taking exceeds the government's authority to take property rights, regardless of whether there is just compensation.

In the context of a potential regulatory taking, the Property Clause requires three separate inquiries:

1) Is the regulatory burden on the property sufficiently substantial to qualify as a "taking" that warrants application of the Property Clause? If not, the Property Clause is no longer relevant.

2) If there has been a regulatory taking, does it comport with the Public Use clause of the Property Clause? If not, just compensation is irrelevant and the regulation is invalid.

3) Finally, if there has been a regulatory taking that comports with the Public Use clause, what just compensation is due?

Petitioner essentially tries to write the second question out of this Court's jurisprudence and the Public Use clause out of the Property Clause.

Although this Court has recognized different standards for determining whether there is a sufficient nexus between the effect of a regulation and a public purpose (compare *Dolan v. City of Tigard*, 512 U.S. 374 (1994) to *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987)), it has never countenanced the radical suggestion, made by petitioner, that such a nexus inquiry is inappropriate altogether. In fact, as this Court stated in *Tahoe-Sierra*, "[a]fter [*Pennsylvania Coal Co. v.*] *Mahon*, neither a physical appropriation *nor a public use* has ever been a necessary component of a 'regulatory taking.'" 535 U.S. at 326 (emphasis added). In essence, a regulatory taking can be found when no public purpose is substantially advanced.

A. The Substantially Advance Standard Provides An Appropriate Level Of Scrutiny For Regulations That Burden Real Property.

In *Yee*, this Court appeared to recognize that the appropriate standard for a real property rent regulation that may result in a premium is the substantially advance standard. 503 U.S. at 533-34. The certiorari petition in *Yee* sought review of whether, as the Ninth Circuit had then determined, California's mobile home rent control constituted a physical taking. This Court concluded that because the landowner had voluntarily rented his land and the record was unclear as to whether the owner could close the park and devote it to another use, a physical taking had not been established on the record before it. But this Court noted that there may be a regulatory taking, because the "regulation goes too far...." *Id.* at 529 (quoting *Pennsylvania Coal v. Mahon*, 260 U.S. 393 (1922)).

This Court focused on the significance of the premium, representing the present value of future rent savings, in

determining whether the regulation complied with the Property Clause. This Court recognized that this mobile home rent control, unlike certain other forms of rent control, "cause[s] a one-time transfer of value...." *Id.* at 529. This Court acknowledged that the "ordinance benefits incumbent mobile home owners without benefiting future mobile home owners" and that "Petitioners are correct in citing the existing of this premium as a difference between the alleged effect of the [mobile home rent control] ordinance and that of an ordinary apartment rent control statute." *Id.* at 530.

In *Yee*, this Court also recognized that because of the premium, the mobile home rent control ordinance "transfers wealth only to the incumbent mobile home owner." *Id.* This Court noted further, "[t]his effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. *Id.* (citing *Nollan*, 483 U.S. at 834-35).

This Court's discussion in *Yee* of the applicability of the substantially advance standard is consistent with the numerous other decisions in which this Court has applied the "substantially advance" standard to regulations that limit the uses of real property, including *Nollan*. Application of the Due Process standard in these circumstances is fundamentally inconsistent with this Court's jurisprudence. Unlike an economic regulation in which no "specific property right or interest has been at stake," *Eastern Enterprises v. Apfel*, 524 U.S. 498, 541 (1998) (Kennedy, J. concurring), the right to determine rent for real property is an integral part of the bundle of rights associated with the ownership of that property. *See Yee*, 503 U.S. at 528 ("the state and local laws at issue here...regulate [the] use of their land").

1. This Court Has Consistently Applied the Substantially Advance Standard For Over Two Decades.

In addition to its decision in *Yee*, this Court has been consistent in its application of the substantially advance standard to regulations that limit the use of real property for over two decades. In *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978), this Court concluded that "a use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose." *Id.* at 127.

In *Agins v. City of Tiburon*, 447 U.S. 255 (1980), this Court recognized that "[t]he application of a general zoning law to particular property" requires a judicial determination of whether the ordinance "substantially advance[s] legitimate state interests...." *Id.* at 260.

In *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), this Court recognized that a use restriction must be "reasonably necessary to the effectuation of a substantial public purpose." *Id.* at 834 (quoting *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978)).

In *Dolan v. City of Tigard*, 512 U.S. 374 (1994), this Court established an even more stringent standard than the "substantially advance" standard in circumstances involving a land use exaction. This Court rejected a "reasonable relationship" standard because it "seems confusingly similar to the term 'rational basis' which describes the minimal level of scrutiny under the Equal Protection Clause...." *Id.* at 391. This Court adopted a "rough proportionality" standard for exactions, that demands an "individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Id.*

In *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 700-704 (1999), this Court reaffirmed that "concerns for proportionality animate the Takings Clause" and

affirmed jury instructions that required jurors "to decide if the city's decision here substantially advanced any such legitimate public purpose...." In doing so, this Court noted that such "instructions are consistent with our previous general discussions of regulatory takings liability." *Id.* at 704.

More recently, in *Tahoe-Sierra Preservation*, this Court specifically referenced that the petitioner might have argued that the regulation "did not substantially advance a legitimate state interest..." but failed to do so. 535 U.S. at 334.

Petitioner offers no justification for jettisoning two decades of jurisprudence. And if there were any doubt about the wisdom of this Court's decisions, this Court need only consider the ability of politically powerful tenants to appropriate property, under the guise of regulation. This Court need look no further for an example of such appropriation than the circumstances presented in *Yee*, *i.e.*, California's mobile home rent control schemes.

2. The Substantially Advance Standard Does Not Invite Judicial Second-Guessing of Legislative Judgments.

The "substantially advance" standard is a moderate one. It does nothing more than ensure that the regulation is reasonably necessary to the effectuation of such a public purpose. It does not permit second-guessing as to the legitimacy of a legislative purpose. Rather, it merely requires a reasonable nexus between that purpose and the effect of the regulation.

In *Del Monte Dunes*, this Court expressly rejected the very argument made by petitioner here – that the "substantially advance" standard would allow "juries to second-guess public land-use policy." 526 U.S. at 704. This Court recognized that the substantially advance standard does not allow the courts to second-guess whether a public purpose is a legitimate public purpose. Rather, the standard limits judicial review to a different question: assuming the public purpose to be valid, whether the regulation substantially advances that public

purpose. *Id.* at 704-05. In fact, the jury in *Del Monte Dunes* was instructed that the various purposes asserted by the city were legitimate public purposes.

The courts are accustomed to making judgments about whether regulations actually advance a public purpose. That standard has been applied consistently in the First Amendment context. *See Thompson v. Western States Medical Center*, 535 U.S. 357, 367 (2002) (determining "whether the regulation directly advances the governmental interest asserted....") (quoting *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557, 566 (1980)). The standard does not invite judicial activism when applied to property rights, any more than it does when applied to protect commercial speech.

While such judgments may occasionally be complex, they are nonetheless appropriate judicial determinations that have been made by judges and juries for many decades now. *See Tahoe-Sierra Preservation,* 535 U.S. at 323 (noting that regulatory takings cases require "complex factual assessments of the purposes and economic effects of government actions") (citing *Yee*, 503 U.S. at 523). As discussed below, the judiciary is the right branch of government to make such complex factual assessments. That is particularly so because there is a risk that the democratic process will reflect the rule of a self-interested "mob" that seeks to take the private property of a politically ineffectual landowner and make it their own.

3. Meaningful Judicial Scrutiny of Regulations that Burden Real Property and May Cause a Premium to Result Is Necessary Because No Compensation or Forum for Challenging the Burden Is Provided by the Government.

Regulatory takings warrant meaningful judicial scrutiny under the Public Use clause, precisely because the government

is not willing to provide compensation or a forum for challenging whether there is a public use. *See Del Monte Dunes*, 526 U.S. at 712-13 ("[W]hen the government initiates condemnation proceedings, it concedes the landowner's right to receive just compensation....Liability simply is not an issue....[But] where...the government not only denies liability but fails to provide an adequate post-deprivation remedy...the disadvantage to the owner becomes all the greater....").

In the eminent domain context, the government acknowledges that it is using the property, and the constitutional inquiry is appropriately deferential to what the government has determined to be a public use. When government regulates real property, it will invariably identify a public use (or purpose) to justify the regulation. But if the regulation does not substantially advance that public purpose, then real property rights have not, in fact, been put to a public use. The result in that circumstance should be no different than if the real property had been physically confiscated and transferred to a private party – that government action is invalid under the takings clause. Thus, the result of a regulation that identifies a purpose but fails to substantially advance it is no different from the government taking land for a highway but then giving it to a private citizen.

Without meaningful judicial scrutiny of the effect of a regulation, there is no means to ensure that the government has not used the guise of regulation to avoid its obligation to compensate a property owner for a burden that should be borne by the public as a whole. *See Nollan*, 483 U.S. at 837.

Additionally, in contrast to a general economic regulation, where a regulation burdens real property, the burdens necessarily fall upon particular landowners, rather than the public as a whole. As a consequence, there is a heightened risk that a burden which ought to be borne by the public as a whole will be borne only by a private party. *See Armstrong v. United States*, 364 U.S. 40, 49 (1960) (Taking Clause "was designed

to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."); *see also Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 492 (1987) (quoting *Agins*, 447 U.S. at 260-61) ("[A] taking, is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest…").

4. Petitioner's Interpretation of the Property Clause Would Read the Public Use Clause out of the Constitution.

Petitioner argues that the only substantive constitutional requirement that the government advance a public purpose in regulating real property is found in the Due Process Clause. (Pet. at 23-24). This argument would effectively read the "public use" condition out of the Property Clause and would require this Court to reverse its decisions in *Nollan*, *Del Monte Dunes*, and *Dolan*, and to contradict its analyses in *Agins*, *Yee*, *Brown*, *Tahoe-Sierra* and other cases.

In *Brown v. Legal Foundation of Washington*, 538 U.S. 216 (2003), this Court recognized in the context of a regulatory taking, that the "text of the Fifth Amendment imposes *two* conditions on the exercise of [the state's] authority: the taking must be for a 'public use' *and* 'just compensation' must be paid to the owner." *Id.* at 231-32 (emphasis added). The "substantially advance" standard gives effect to the first condition – it serves to ensure that, in the regulatory taking analysis, there is a reasonable relationship between the burden on property and the public purpose the government seeks to advance.

As noted, the Public Use clause is indisputably applicable to physical takings. A "purely private taking could not withstand the scrutiny of the public use requirement; it would serve no legitimate purpose of government and would thus be

void." 467 U.S. at 245. There is no apparent reason to dispense with this textual constitutional requirement merely because the taking is accomplished by regulation.

Failure to treat the "public use" clause as an essential condition of governmental regulations that burden real property would gut the Property Clause of any significance, other than to ensure compensation. It would license the government to take any property rights that it wants, without regard to whether it is advancing a legitimate purpose of government, provided it do so by regulation rather than through a condemnation. Where the government directly invokes its eminent domain power, a landowner is afforded a forum in which to challenge whether the action is for a "public use." The government should not be permitted to avoid that inquiry merely because it takes property rights through regulation, rather than through eminent domain.

B. The Substantially Advance Standard is Particularly Appropriate In Reviewing a Rent Regulation.

This Court has applied and recognized the "substantially advance" standard in a wide variety of circumstances involving restrictions on the use of real property. *See* Section II, *infra*. As reflected by the discussion in *Yee*, a rent regulation is functionally no different than a "use" regulation – by limiting what rent a landlord may charge for property, the regulation necessarily limits the uses to which it may be put. Thus, in *Yee*, this Court recognized that the substantially advance standard would be the appropriate standard for evaluating whether mobile home rent control gives rise to a regulatory taking.

Similarly, in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), Justice Kennedy's pivotal opinion recognized that whether a regulation constitutes a taking may turn on whether it affects a property interest. *Id.* at 540 (Kennedy, J., concurring) ("[The regulation] does not operate upon or alter an

identified property interest, and is not applicable to or measured by a property interest."). Rent control operates on a real property interest and deprives the owner of the most valuable property interest in the land – the power to determine the price at which the owner is willing to rent the land.

And in the context of mobile home rent control, the burden often falls on a small group of landowners. *See Nollan*, 483 U.S. at 835 n.4 ("If the Nollans were being singled out … the State's action, even if otherwise valid, might violate the incorporated Takings Clause…."). The substantially advance standard is minimally necessary to protect owners of real property from the disproportionate burden that mobile home rent control will otherwise impose.

C. The Application of the Substantially Advance Standard is Particularly Appropriate Where There is a Likelihood of a Premium.

Moreover, even if there were somehow a basis for not applying the "substantially advance" standard to all real property rent regulations, there is particular reason to apply it to real property rent regulations that may give rise to a premium. In *Nollan*, this Court recognized that heightened risks that a regulation will serve no purpose warrant increased scrutiny:

> As indicated earlier, our cases describe the condition for abridgment of property rights through the police power as a "substantial advanc[ing] of a legitimate state interest. We are inclined to be particularly careful about the adjective where the actual conveyance of property is made a condition to the lifting of a land-use restriction, since in that context *there is heightened risk that the purpose is avoidance of the compensation requirement,* rather than the state police-power objective.

Id. at 841 (emphasis added).

When a rent regulation may give rise to a premium, there is precisely such a heightened risk. As this Court recognized in *Yee*, the absence of a mechanism to prevent a premium suggests that the purpose of the regulation may be to transfer the value of property from one private party to another, without providing compensation. The risk is heightened because a premium reflects that the regulation will be ineffectual or even, as with mobile home rent control, counterproductive in achieving its stated purpose.

Thus, petitioner provides no reason to revisit this Court's consistent application of the "substantially advance" standard to vindicate the important property interests that are protected by the Public Use clause of the Property Clause. And, as set forth below, in no event should this Court question the application of that standard in the egregious circumstances presented by California's mobile home rent control.

III. THERE IS NO BASIS TO DISTURB THE NINTH CIRCUIT'S APPLICATION OF THE SUBSTANTIALLY ADVANCE STANDARD IN THIS CASE OR IN THE CONTEXT OF CALIFORNIA'S MOBILE HOME RENT CONTROL.

Consistent with this Court's discussion in *Yee* and its many affirmations of the substantially advance standard, the Ninth Circuit has appropriately applied that standard to California's mobile home rent control and other rent regulations that fail to provide a mechanism to prevent the creation or transfer of a premium.

A. The Ninth Circuit Has Faithfully Applied This Court's Decisions.

In *Richardson v. City & County of Honolulu*, 124 F.3d 1150, 1164 (9th Cir. 1997), the Ninth Circuit faithfully recounted this Court's analysis in *Yee*. It considered a rent regulation that the District Court had found would create a premium that an "owner-occupant can capture when she sells a

condominium subject to a re[gulated] land rent" and in which the transferor will "charge a premium reflecting the net present value of the difference between the [regulated] land rent and the free market land rent." *Id.* at 1165. The District Court found this regulation "effected a transfer of wealth from lessors to lessees" that "does not occur in the ordinary rent control ordinance...." *Id.*

The Ninth Circuit also recognized in *Richardson* that, under this Court's decision in *Nollan*, "[l]and use regulations do influence the value of property, but to be constitutional, they must do so in a manner that substantially furthers a legitimate government purpose." *Id.* It found that the rent regulation at issue did not advance a government purpose because

> [t]he absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu. Incumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium. The price of housing ultimately will remain the same.

Id. at 1166.

More recently, the Ninth Circuit applied the "substantially advance" standard to the factual context presented in *Yee*: California's mobile home rent control. It recognized that, generally, a mobile home rent control ordinance that does not provide for a mechanism to prevent the capture of a premium will not substantially advance any government purpose. *Cashman*, 374 F.3d at 896. In *Cashman*, notwithstanding the demonstrated pernicious effects of California's mobile home rent control, the Ninth Circuit exercised appropriate restraint and recognized that, in some case, there may be externalities

that prevent a premium from arising. *Id.* at 899. Its decision was consistent with this Court's every discussion of the "substantially advance" standard.

B. This Case Was Correctly Decided.

In this case, the Ninth Circuit properly applied these principles to Hawaii's regulation of independent dealer-leases. The Ninth Circuit recognized that, notwithstanding the absence of a mechanism to preclude a premium, there was some possibility that a premium would not be created or transferred – because Chevron might recoup any lost rent through increased gasoline prices. Thus, the Ninth Circuit appropriately required a trial on whether the regulation had a reasonable nexus to its legislative purposes. That inquiry was no different than the inquiry that this Court approved in *Del Monte Dunes*. Whether or not the District Court properly weighed the evidence before it, there is no reason to depart from the "substantially advance" standard in connection with a rent regulation that lacked a mechanism to prevent a premium.

This case, like cases involving mobile home rent control, concerns a substantial burden on real property. It concerns the most fundamental stick in the bundle of property rights – the right to determine what compensation a property owner may ask or receive for the use of one's property. The setting of price will invariably affect the use of the property. A property owner whose revenue is limited, is limited in the improvements he or she can make to the land. There is no more fundamental aspect of a market society than the ability to set price; there is no greater danger to the free enterprise system than when the government sets prices.

Consistent with *Richardson* and *Cashman*, this case raises unique factual questions regarding whether "externalities" preclude a premium. This case raises factual issues as to whether the property owner was economically injured by the regulation, or whether it was able to recoup its lost rent

through increased gasoline prices. It also raises factual issues as to whether, unlike the housing market, there are sufficient unregulated suppliers to ensure an effective market. The case raises a factual issue as to whether the regulation lowered the price of gasoline or otherwise substantially advanced any legitimate purpose. But the complexity of those factual issues provides no grounds to revisit a well-established and highly functional legal standard.

To the contrary, lest this Court harbor any doubt, the well-established failures of California's mobile home rent control, and the breakdown of the democratic process in connection with it, demonstrate the wisdom and necessity of meaningful judicial scrutiny of whether rent regulations substantially advance a legitimate purpose.

CONCLUSION

The substantially advance standard serves an important purpose in giving effect to the Public Use clause of the Property Clause. It is particularly appropriate where rent regulations result in premiums that reflect a capitalization of any benefits the regulation may otherwise provide. This Court should affirm the decision of the Ninth Circuit in this case. And in no event should it revisit the applicability of the "substantially advance" standard in the context of California's uniquely pernicious mobile home rent control.

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In The Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF THE LEAGUE OF CALIFORNIA CITIES AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

Amicus curiae the League of California Cities submits this brief in support of petitioners.[1] This case involves a challenge based upon the Takings Clause of the Fifth Amendment to the right of democratically elected legislatures to establish economic policy. Seeking to preserve competition in the retail gasoline market, the State Legislature of Hawaii limited the rent oil companies may charge dealer/lessees to use oil company-owned service stations. The Ninth Circuit Court of Appeals found that federal courts have the power to strike down such statutes as "takings" where the court determines, based on its own weighing of evidence presented in court, that the regulation will not be effective.

Each of the member cities of the League is within the jurisdiction of the Ninth Circuit, and is therefore subject to that court's decision in this case. Because the Ninth Circuit's transfer of power to formulate economic policy from legislatures to courts could have pervasive implications for local regulatory authority under the police power, this Court should consider the cities' viewpoint in this brief.[2]

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[1] The League of California Cities is an association of all 478 California cities united in promoting the general welfare of cities and their citizens. The League is advised by its Legal Advocacy Committee, which is comprised of 24 city attorneys representing the 16 divisions of the League from all parts of the state. The Committee monitors appellate litigation affecting municipalities and identifies those cases that are of statewide significance.

[2] Counsel for the parties did not author this brief in whole or in part. No person or entity other than the *amicus* made a monetary contribution to the preparation or submission of this brief. Petitioners and respondent have filed a blanket consent to the filing of *amicus* briefs.

INTRODUCTION AND SUMMARY OF ARGUMENT

At issue in this case is which branch of government determines economic policy: democratically elected legislatures or courts. *Agins v. City of Tiburon*, 447 U.S. 255 (1980) has led to this controversy. In that case, the Court stated that courts are empowered to find that a regulation effects a "taking" of property under the Takings Clause of the Fifth Amendment if the regulation fails to "substantially advance legitimate state interests." *Id.* at 260. Here, the Ninth Circuit applied the substantially advance test to make economic policy. *Chevron USA, Inc. v. Cayetano*, 224 F.3d 1030 (9th Cir. 2000), *cert. denied*, 532 U.S. 942 (2001) ("*Chevron I*"), *on remand*, 198 F.Supp.2d 1182 (D. Ha. 2002), *aff'd sub nom., Chevron USA, Inc. v. Bronster*, 363 F.3d 846 (9th Cir. 2004) ("*Chevron II*").

The Court should reverse the Ninth Circuit opinion for two reasons. First, in applying the substantially advance test to the Hawaii law in question, the Ninth Circuit usurped legislative power. The lower court determined that the regulatory means chosen by the Hawaii Legislature to address an economic problem will not be effective to achieve its ends. Until *Agins*, this Court had consistently held that the Due Process Clause provides the proper framework for judicial review of the wisdom and efficacy of government regulation. The Court limited regulatory takings to circumstances where regulation severely diminishes property value. The text of the Takings Clause, its original understanding, takings jurisprudence, and fundamental principles of democracy provide no support for importing a means-ends test to the Takings Clause.

Second, since *Agins*, this Court and the lower federal and state courts have interpreted the substantially advance takings test to require either: (1) deferential judicial review – a test akin to rational basis, ordinarily associated with the Due Process Clause; or (2) nondeferential review – known as "heightened scrutiny." The nondeferential standard of review arises from this Court's decisions in *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987) and *Dolan v. City of Tigard*, 512 U.S. 374 (1994). In those cases, the Court held that the judiciary may apply heightened scrutiny to exactions of physical interests in land imposed as conditions of approval of individual permit applications. However, as this Court recognized in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702 (1999): "[W]e have not extended the rough proportionality test of *Dolan* beyond the special context of exactions – land-use decisions conditioning approval of development on the dedication of property to public use."

Nevertheless, in this case, the Ninth Circuit went beyond administratively imposed, adjudicatory land exactions to apply heightened scrutiny to price control legislation. The Ninth Circuit opinion allows the courts to discard any notion of deference to the decisions of a legislative body as to the efficacy of economic regulation. Accordingly, the Ninth Circuit has vastly expanded judicial power to second-guess legislative policy decisions. Under *Chevron*, unelected and life-tenured judges would become super-legislatures, substituting their judgments as to wise and effective economic policy for those of elected and politically accountable representatives. This frontal assault on representative democracy runs contrary to basic principles of separation of powers and should be rejected by this Court. Finally, because the heightened

standard of judicial review embraced in *Chevron* would be more attractive to takings claimants than the deferential standard applied in most state courts, *Chevron* would promote forum-shopping and deluge the federal courts with challenges to a variety of economic regulations.

STATEMENT OF THE CASE

In 1997 Hawaii adopted Act 257 ("Act") to, among other things, limit rents that oil companies may charge their retail gas station dealer/lessees for leasing company-owned stations to 15% of the dealer/lessee's gross profit from gasoline sales. App. 2.[3] The Act is designed to prevent oil companies from increasing rents to levels that would likely push independent dealers out of the already limited retail gasoline market.

Relying on *Agins*, *Nollan*, and *Yee v. City of Escondido*, 503 U.S. 519 (1992), Chevron challenged the Act as a regulatory taking on the ground, among others, that the Act does not substantially advance legitimate state interests. App. 3, 103. Applying heightened scrutiny to the Act, the district court entered summary judgment for Chevron on its takings claim. App. 103-116.

In a two-to-one decision in *Chevron I*, the Ninth Circuit concluded that the district court correctly held that heightened scrutiny applied, allowing the court to inquire into the efficacy of the Act. App. 58-60. However, the majority found that whether the Act substantially advanced

[3] Citations to the decisions of the lower courts are to the Appendix to the Petition for a Writ of Certiorari.

legitimate state interests raised triable issues of fact, and remanded the case to the district court for an evidentiary hearing as to whether the Act would actually accomplish its purpose. App. 79.[4]

On remand, the district court applied the substantially advance standard to determine whether the Act effected a taking. To predict the economic effects of the Act, the court heard testimony from economists representing each side. App. 40-50. The district court agreed with the theories advanced by Chevron's economist. The district court concluded that the Act effects a taking because it "does not substantially advance the State's legitimate interest in lowering gasoline prices." App. 53.

On appeal in *Chevron II*, the State argued that the substantially advance standard is not a legitimate test for a taking, and even if it were, that the district court, out of deference to the judgment of the Hawaii Legislature, should have applied a standard of review equivalent to the due process rational basis test. App. 5. The same panel of the Ninth Circuit affirmed, again in a two-to-one decision. Relying on the law of the case, the majority rejected the State's arguments. App. 13-16. The court addressed the State's arguments on the merits, however, finding that the court's application of heightened review in *Chevron I* was not clearly erroneous. App. 14-16. In his dissenting opinion, Judge Fletcher objected to the court's application of heightened scrutiny: "Rent control is often inefficient and

[4] The Ninth Circuit mistakenly assumed that the purpose of the Act was to *decrease* current gasoline prices, rather than to maintain robust competition, prevent monopolization, and ultimately avoid consumer price *increases*. App. 18, 21.

sometimes unfair. But we should not confuse inefficiency and unfairness with unconstitutionality." App. 29.

ARGUMENT

I. THE COURT SHOULD PRESERVE THE AUTHORITY OF ELECTED LEGISLATURES TO DECIDE THE WISDOM AND EFFICACY OF ECONOMIC REGULATION.

A reversal of *Chevron* is critically important for *amici* cities. The cities – like the state and federal government – have enacted scores of laws regulating economic activity to promote the general health, safety, and welfare and continue to enact such regulations daily. *Chevron* invites legal challenges to every one of these regulations as a taking.

Chevron allows aggrieved property owners, and indeed, businesses of all kinds, to avoid the political process entirely. If the decision stands, courts could be permitted to assume the role of legislatures, and the public would be denied a voice in matters that have direct and immediate impact on their health, safety, property values, economic welfare, and quality of life. The framers of the Constitution could not possibly have intended this result.[5] This Court should therefore overrule *Chevron* and

[5] *See, e.g., Vieth v. Jubelirer*, 541 U.S. 267, 124 S.Ct. 1769, 1776 (2004) ("Sometimes ... the judicial department has no business entertaining the claim of unlawfulness – because the question is entrusted to one of the political branches. ..."); *Vance v. Bradley*, 440 U.S. 93, 97 (1979) ("The Constitution presumes that ... even improvident decisions will eventually be rectified by the democratic process and that judicial intervention is generally unwarranted no matter how

(Continued on following page)

establish a standard of review of economic regulation that preserves traditional deference to the policy decisions of legislative bodies, whether federal, state, or local. Reaffirming deferential judicial review of legislative economic regulations is essential for the continuing vitality of "the democratic faith which we profess." *See Joint Anti-Fascist Refugee Committee v. McGrath*, 341 U.S. 123, 162 (1951) (Frankfurter, J., concurring).

A. *Chevron* Conflicts with Representative Democracy.

The Constitution embodies the doctrine of separation of powers between the legislative and judicial branches. The separation of powers protects decisions of the legislature from lateral attack by another branch. *Gorieb v. Fox*, 274 U.S. 603, 608 (1927). The legislative and executive branches hold authority to make social and economic policy. As the Supreme Court has consistently recognized in cases involving the powers of the other branches, the

unwisely we may think a political branch has acted."); *Baker v. Carr*, 369 U.S. 186, 217 (1962) (question is political rather than legal where it is impossible for court to "undertak[e] independent resolution without expressing lack of the respect due coordinate branches of the government"); *Metromedia, Inc. v. San Diego*, 453 U.S. 490, 570 (1981) (Rehnquist, J., dissenting) ("[L]ittle can be gained in the area of constitutional law, and much lost in the process of democratic decision-making, by allowing individual judges in city after city to second-guess ... legislative ... determinations" on aesthetic matters); *Mistretta v. United States*, 488 U.S. 361, 415 (1989) (Scalia, J., dissenting) ("Except in a few areas constitutionally committed to the Executive Branch, the basic policy decisions governing society are to be made by the Legislature."); *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209, 258 (1977) (Powell, J., concurring) ("Under our democratic system of government, decisions on ... critical issues of public policy have been entrusted to elected officials who ultimately are responsible to the voters.").

Constitution limits the role of the judiciary to restraining the *arbitrary* exercise of legislative authority. *E.g.*, *Dolan*, 512 U.S. at 391 n.8.

The hallmark of democracy is "participatory self-government." Steven Breyer, "Our Democratic Constitution," Harvard University Tanner Lectures on Human Values 2004-2005 (Nov. 17-19, 2004), at 5; *see also id.* at 39. To work effectively, a democratic system must allow citizens equal opportunity to control the decision making agenda. ROBERT A. DAHL, DEMOCRACY AND ITS CRITICS 112-13 (1989). Each citizen must also possess the right to express preferences for a decision, meaning that each citizen's vote should receive equal weight. *Id.* at 109. Majority rule promotes this self-determination. "[T]he strong principle of majority rule ensures that the greatest possible number of citizens will live under laws they have chosen for themselves." *Id.* at 138.

One of the primary roles of the judiciary is to rein in the excesses of the other branches of government. The judiciary ensures that legislative enactments and executive actions are within the Constitution. ROBERT A. DAHL, HOW DEMOCRATIC IS THE AMERICAN CONSTITUTION? 153 (2001). The role of the courts in reviewing legislation to protect fundamental liberties is well established. *Id.* When courts venture outside this realm into policy making that does not implicate fundamental rights, however, the courts frustrate democratic ideals. *Id.* at 153-54. Allowing judges to review legislative policy under a test as standardless as the means-ends takings analysis applied in the instant case creates the risk that their personal philosophical beliefs will color their decisions. *See* NEIL DUXBURY, PATTERNS OF AMERICAN JURISPRUDENCE 272-76, 473-74 (1995) (highlighting risks of judicial activism).

Once accepted, judicial review of legislation under the substantially advance test has no principled stopping point. And placing power in the hands of an unelected, life-tenured judiciary to declare that regulations are takings on the grounds that they will not achieve their avowed purpose conflicts sharply with self-governance. In recognition of these hallmark principles of our democratic system of government, this Court has consistently and sharply limited the authority of judges to interfere with legislative control of purely economic activity, by confining searching judicial review to regulations that affect fundamental rights. *See*, *e.g.*, *Williamson v. Lee Optical*, 348 U.S. 483, 487-89 (1955).

Act 257 does not implicate fundamental rights. Accordingly, the determination that the regulation will achieve some legitimate state interest should be subject to the sound discretion of the legislature. Whether a price control such as that at issue here will have its intended effect in a complex industry may be debated in lengthy legislative committee hearings, in which economists, consumer advocates, industry participants, and even individual legislators present divergent views on the question. Along with that gathering of evidence, legislators weigh the opinions of constituents affected by the proposed regulation, and then fashion a policy intended to promote the general health, safety, and welfare.

Predicting the impact of price controls in a complex business such as the motor fuel industry is quintessentially a legislative policy function. The courts have no greater right to legislate this policy than they have to dictate zoning decisions, safety requirements for autos, or the proper procedure for pasteurizing milk. In this case, by extending no deference to the State Legislature of Hawaii

on a question of economics, the district court assumed a legislative role. Had the district court based its decision on past effects on retail gasoline prices, the court would nonetheless have usurped the legislature's policy making function. But here, the district court engaged in a particularly egregious violation of the separation of powers by sustaining a *facial* challenge to the Act. The trial court *predicted* that the Act *would have* particular effects. The expert testimony predicting the effects of the Act was not "evidence," however, nor were the district court's rulings findings of "fact" or conclusions of "law." *See* App. 32, 50. The expert testimony on which the district court here relied was little more than speculation as to the effects of the Act. The court simply embraced one economic theory over another. *See* App. 43. In any event, the process of determining economic policy by predicting the economic effects of proposed regulation is fundamentally a legislative function. It is not a function the courts are well-equipped to perform and it is outside of their proper adjudicative role.

Chevron raises the potential for abuse of judicial power with regard to all government regulation, not merely price controls. If *Chevron* were allowed to stand, then the deferential rational basis test, historically applicable to economic legislation, would be eviscerated. The court's proposal in *Chevron* that the federal courts should conduct their own evidentiary hearings to predict the effects of legislation defeats principles of self-governance and representative democracy.[6]

[6] The *Chevron I* majority noted that its decision should be narrowly applied and that it "save[s] for another day the question of whether the 'substantially advances' test applies outside the context of rent control

(Continued on following page)

B. *Chevron* Would Promote Inefficiency and Chaos in Economic Policymaking.

If courts were the final arbiters of economic policy, the legislative enactment of an economic policy would mark only the beginning of the decision making process. The validity of any policy would remain unsettled for years as challenges to the legislation wound their way through the courts. Removing certainty as to the validity of economic regulation would chill business and real estate investment.

Moreover, the nondeferential standard of judicial review will flood the courts with lawsuits by business and property owners, as virtually any economic regulation would be subject to challenge as a taking. The government could be compelled to defend thousands of laws in evidentiary proceedings, at colossal cost to the taxpayers.

Nor do the courts have the institutional competence to study and mediate between competing interests in any industry – a function that is the essence of law making. A court confronted with a complex issue of economic regulation is no substitute for a local legislative agency that can see the larger picture in its jurisdiction or region. Economic regulations are often interdependent. Effective economic regulation requires a broader perspective than one isolated case at one point in time. Decisions as to the most effective economic policies are best made by legislatures taking the initiative to identify problems, receiving

statutes that permit the capture of a premium." App. 65. But the court's reasoning that legislatures cannot be entrusted to make policy with respect to the economic relations between commercial landlords and tenants could logically be applied to all types of regulation.

evidence from a wide range of affected parties and interest groups, debating the advantages and disadvantages of alternative policies, and compromising in order to reach a majority decision. A court with hundreds of cases on its docket is not the proper forum to make such economic policy.

C. *Chevron* Would Encourage Forum Shopping and Multiply Litigation in the Federal Courts.

In *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 192-95 (1985), this Court held that a takings claimant must seek compensation in state court under state procedures before a federal takings claim arises. Contradicting *Williamson County*, however, the Ninth Circuit has held that a facial challenge to regulation on the ground that it does not substantially advance legitimate state interests is ripe in federal court even though the claimant has not sought compensation in state court. *Sinclair Oil Corp. v. County of Santa Barbara*, 96 F.3d 401, 407 (9th Cir. 1996), *cert. denied*, 523 U.S. 1059 (1998); *San Remo Hotel v. City and County of San Francisco*, 145 F.3d 1095, 1102 (9th Cir. 1998).

Although it is settled law in California that deferential judicial review applies to economic legislation challenged under the Takings Clause, *see San Remo Hotel v. City and County of San Francisco*, 41 P.3d 87, 101-03 (Cal. 2002); *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993, 1001-02 (Cal. 1999), *cert. denied*, 526 U.S. 1131, *Chevron* applies nondeferential review. While most takings claims must be litigated in state court, *Chevron's* more favorable treatment of facial substantially advance claims will generate considerably more substantially advance

takings challenges to legislation and induce many takings claimants to elect the federal forum, in defiance of *Williamson County*. The result would be confusion and inconsistent adjudications as between the federal and state courts. *Amici* cities would find it difficult to discharge their governmental functions under such uncertainty as to the standard of judicial review of their enactments. Moreover, the more generous federal courts would be deluged with challenges to every manner of local economic regulation.

II. THE COURT SHOULD DISAPPROVE THE SUBSTANTIALLY ADVANCE TEST FOR REGULATORY TAKINGS OTHER THAN ADJUDICATORY EXACTIONS.

A. The Substantially Advance Test is Not a Legitimate Takings Test.

The legitimacy of the substantially advance test as a test for a regulatory taking is open to serious debate. The degree of judicial deference to legislative enactments has fluctuated over time. Between 1897 and 1936, the Supreme Court imposed a *laissez faire* economic philosophy, interfering with legislated health and safety regulation. In its most extreme application of *laissez faire*, *Lochner v. New York*, 198 U.S. 45 (1905), the Court struck down a state law designed to safeguard the health of bakers by limiting their working hours. In *Lochner*, the Court intruded on a core police power, freely exercising its own judgment as to the appropriate policy for the health of bakers. *See id.* at 56-57. But Justice Oliver Wendell Holmes' dissent in *Lochner* laid the foundation for the eventual repudiation of *Lochner's* free-market philosophy: "Some of these laws embody convictions or prejudices

which judges are likely to share. Some may not. But a Constitution is not intended to embody a particular economic theory, whether of paternalism . . . or of *laissez faire*. . . ." *Id.* at 75.

Beginning in 1934 and continuing for more than 50 years, the Court abandoned the intrusive *Lochner* standard.[7] In *United States v. Carolene Products Co.*, 304 U.S. 144 (1938), the Court thoroughly embraced the deferential standard of review of economic legislation:

> [T]he existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless . . . it is of such a character as to preclude the assumption that it rests on some rational basis. . . . *Id.* at 152.

Since the demise of *Lochnerian* substantive due process, this Court has generally reviewed economic regulation under the Due Process Clause by applying the deferential rational basis test.[8] Under that test, the court must uphold the regulation unless no reason can be conceived to support it. *Carolene Products*, 304 U.S. at 152.

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[7] *See, e.g., Nebbia v. New York*, 291 U.S. 502, 537 (1934) ("[A] state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose"); *Ferguson v. Skrupa*, 372 U.S. 726, 731-32 (1963) ("We refuse to sit as a 'superlegislature to weigh the wisdom of legislation'. . . . Whether the legislature takes for its textbook Adam Smith, Herbert Spencer, Lord Keynes or some other is no concern of ours.").

[8] *See, e.g., Pennell v. San Jose*, 485 U.S. 1, 11, 14 (1988) (proper standard of judicial review of legislative rent control is deferential); *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 388 (1926) ("If the validity of the legislative classification for zoning purposes be fairly debatable, the legislative judgment must be allowed to control").

The burden is on the party challenging the regulation to prove that it constitutes an arbitrary regulation of property rights. *Id.* Indeed, in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), this Court upheld a Maryland statute strikingly similar to Act 257 against a due process challenge. The Maryland law sought to foster competition among retail gas suppliers by prohibiting oil companies from owning retail gas stations. The Court emphatically rejected the notion that the courts have a role in forging this type of economic policy:

> Responding to evidence that producers and refiners were favoring company-operated stations in the allocation of gasoline and that this would eventually decrease the competitiveness of the retail market, the State enacted a law prohibiting producers and refiners from operating their own stations. Appellants argue that this response is irrational and that it will frustrate rather than further the State's desired goal of enhancing competition. But . . . this argument rests simply on an evaluation of the economic wisdom of the statute, and cannot override the State's authority "to legislate against what are found to be injurious practices in their internal commercial and business affairs. . . ." *Id.* at 124 (citations omitted).

In *Agins*, however, in 1980, this Court set the stage for a potentially different standard of judicial review of economic regulation. In that case, the Court introduced a means-ends test for land use regulation under the Takings Clause. The Court stated in dictum that the application of a zoning law to property effects a taking if the law "does not substantially advance legitimate state interests." 447 U.S. at 260.

The substantially advance test conflicts with the plain language of the Takings Clause, which requires the payment of compensation for taking of private property for public use. It is difficult to discern how the failure of a regulation to fulfill a valid public purpose could "take" property. Before *Agins*, the Takings Clause had never been understood as a substantive limit on governmental power. As one commentator observed, the Framers of the Constitution did not intend the Takings Clause

> to impose a substantive limit on congressional expropriations. Rather, they intended to distinguish a certain type of taking which required compensation (expropriations) from those which did not (taxes and forfeitures). In essence, the drafters merely intended to ensure that compensation was given when a citizen was called upon to contribute more than his fair share to support the government. . . . [I]f read properly, the expropriation clause of the Fifth Amendment is nothing more than a compensation clause. Matthew P. Harrington, *"Public Use" and the Original Understanding of the So-Called "Takings" Clause*, 53 HASTINGS L.J. 1245, 1248-49 (2002)

See also Eastern Enterprises, Inc. v. Apfel, 524 U.S. 498, 545 (1998) (Kennedy, J., concurring and dissenting) ("the Takings Clause . . . has not been understood to be a substantive or absolute limit on the Government's power to act"); *id.* at 554 (Breyer, J., dissenting) ("[A]t the heart of the Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for legitimate government action that takes 'private property' to serve the 'public' good.") (emphasis original).

Moreover, the substantially advance test lacks any basis in takings jurisprudence. In *Penn Central Transportation*

Co. v. City of New York, 438 U.S. 104, 127 (1978), the Court first referred to a means-ends test under the Taking Clause in reliance on two due process cases, *Nectow v. Cambridge*, 277 U.S. 183 (1928) and *Moore v. East Cleveland*, 431 U.S. 494 (1977). Two years later, in *Agins*, the Court formalized this means-ends test for a taking, once again relying on *Nectow*. *Agins*, 447 U.S. at 260. No takings decision of this Court supports grafting a means-ends test to the Takings Clause. To the contrary, the substantially advance test directly conflicts with other decisions of this Court. In *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987) the Court unanimously held that takings analysis is not concerned with the effectiveness of legislation. *Id.* at 487 n.16; *id.* at 511 n.3 (Rehnquist, J., dissenting). And in *Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229 (1984), the Court concluded that courts should defer to the legislative determination of public purpose in direct condemnation actions. *Id.* at 242. There is no principled reason to depart from that rule in inverse condemnation.

B. If the Substantially Advance Test Were a Legitimate Takings Test, the Standard of Review Under That Test Should be Equivalent to the Due Process Standard.

Even if the Court does not repudiate the substantially advance test, it should settle the meaning of the test. Since the Court decided *Agins*, different standards of judicial review have evolved under the substantially advance test. Nondeferential review of the type employed here by the Ninth Circuit, known as "heightened scrutiny," applies to "exactions" imposed on a case-by-case basis – where the government conditions approval on an owner's

dedication of land to the public to offset the impact of a proposed project. *Nollan*, 483 U.S. at 841; *Dolan*, 512 U.S. at 385. Heightened scrutiny imposes the burden on the government to "make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Dolan*, 512 U.S. at 391. The Court has also found that heightened scrutiny is appropriate for administratively imposed exactions of real property interests because such regulations resemble physical takings. *See Nollan*, 483 U.S. at 831; *see also Dolan*, 512 U.S. at 385.

In contrast, this Court has indicated that a deferential standard continues to apply to generally applicable economic regulation because the risk of the use of the police power to exact unconstitutional conditions is not present. *Nollan*, 483 U.S. at 834-35; *see also Dolan*, 512 U.S. at 385 (courts do not apply heightened scrutiny to regulations that "involve[] essentially legislative determinations classifying entire areas of the city"). The implicit justification for this distinction is that groups of citizens have greater power to influence land use policy in the legislative process and thus require less protection from government overreaching than do individuals engaged in administrative, adjudicatory decision-making proceedings. *See id.*

Consistent with *Nollan* and *Dolan*, five justices in *Eastern Enterprises* held that courts should apply deferential review to the substance of generally applicable legislation. Significantly, a majority of the justices rejected the notion that the "substantially advance" prong of *Agins* enunciated a freestanding takings test outside the *Nollan/Dolan* context of administratively compelled dedications of land. Five justices indicated that the deferential substantive due process test, rather than a takings analysis, should

be applied to a law requiring the payment of money. 524 U.S. at 545-46 (Kennedy, J., concurring and dissenting), 554-58 (Breyer, J., dissenting, joined by Stevens, Souter, and Ginsburg, JJ.). As Justice Kennedy stated, the wisdom of governmental action that does not require the dedication of possessory interests in real property is more appropriately analyzed under "general due process principles rather than under the Takings Clause." *Id.* at 545 (Kennedy, J., concurring and dissenting).[9] Accordingly, if the Court determines that the substantially advance test is a legitimate takings test, then the Court should rule that the substantially advance test requires no higher standard of judicial review of economic legislation than the rational basis test applied under due process.

[9] Other circuit courts have treated as binding this Court's five-four majority holding in *Eastern Enterprises* that the Takings Clause is not a substantive limit on the state's police power. In *Commonwealth Edison Company v. United States*, 271 F.3d 1327 (Fed. Cir. 2001), *cert. denied*, 535 U.S. 1096 (2002), the court observed: ["F]ive justices of the Supreme Court in *Eastern Enterprises* agreed that regulatory actions requiring the payment of money are not takings. We agree with the prevailing view that we are obligated to follow the views of that majority." *Id.* at 1339-40; *see also Unity Real Estate Co. v. Hudson*, 178 F.3d 649, 659 (3d Cir. 1999), *cert. denied*, 528 U.S. 963 (lower courts "are bound to follow the five-four vote (in *Eastern Enterprises*) against the takings claim. . . ."); *Kitt v. United States*, 277 F.3d 1330, 1336-37, *mod. on other grounds*, 288 F.3d 1355 (Fed. Cir. 2002) (same).

CONCLUSION

The judgment should be reversed.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

LINDA LINGLE,
GOVERNOR OF THE STATE OF HAWAII, *et al.*,
Petitioners,

v.

CHEVRON USA, INC.,
Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF *AMICUS CURIAE* OF MANUFACTURED HOUSING COMMUNITIES OF ARIZONA, INC. IN SUPPORT OF RESPONDENT

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equal to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo*, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

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INTEREST OF AMICUS CURIAE[1]

This brief is submitted in support of the Respondent herein.

Manufactured Housing Communities of Arizona, Inc. (MHCA) is a statewide organiztion of owners and managers of mobile home parks throughout Arizona. Arizona does not presently allow rent control but in recent years the legislature has considered changing that policy.

The Arizona Mobile Home Parks Residential Landlord and Tenant Act (ARS §33-1401 *et seq.*) which applies to the rental of lots to tenants owning their own mobile homes, creates a "perpetual lease" by preventing a landlord from terminating or refusing to renew an existing tenant's rental agreement without narrowly defined "good cause". ARS §33-1476(B). If a tenant wishes to sell his mobile home on-site, the landlord must permit the purchaser to become a replacement tenant unless he has reasonable cause to disapprove the purchaser's application. ARS §33-1452(D)(3).

Unlike a number of other states including California, the Arizona Act specifically prohibits local rent control, pre-empting that subject to the State. ARS §33-1416-(A). Arizona has not, to date, imposed any controls over what landlords may charge tenants as rent.

In recent years, however, the Arizona legislature has considered bills imposing rent control on mobile home

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[1] Petitioners and Respondent have filed global consents to the filing of all *amicus* briefs in this case. No counsel for a party authored this brief in whole or in part. No persons or entities other than the *amicus* made a monetary contribution to the preparation or submission of this brief.

park landlords. These bills have been sponsored by organizations representing the interests of mobile home park tenants. There are approximately 400,000 people residing in about 2,000 Arizona mobile home parks. In terms of numbers of interested voters in the state, those favoring rent control vastly outnumber those opposed.

This organization, then named the Arizona Mobile Housing Association, Inc., submitted an *Amicus Curiae* brief in 1991 in *Yee v. City of Escondido*, 503 U.S. 519 (1992). It was concerned at that time that the "perpetual lease" alone represented a physical taking. *Yee*, of course, raised the question of whether the "perpetual lease" created by California law coupled with a local rent control ordinance amounted to a physical taking where the result of the combination was the creation of a "premium" in favor of the tenant. Such a premium reflects a transfer of value from landlord to tenant resulting from imposition of rent control.

Yee concluded that a physical taking did not result from these circumstances but left undecided whether the combination of a rent control ordinance with a perpetual lease may amount to a regulatory taking. The MHCA believes that the instant case may well answer that question.

While Arizona still does not have any rent control laws in place, bills creating mobile home park rent control have been gathering greater legislative support as tenants organize to support them. The instant case has the potential of establishing the standards which must be met for a rent control law to satisfy the requirements of the Takings Clause; that is, whether the law merely has some rational basis or, alternatively, whether it must substantially advance a state interest.

MHCA wishes to bring into focus the compelling need for adoption of the latter standard in a situation involving a state with no current rent control but which is now grappling with whether to adopt such legislation.

SUMMARY OF ARGUMENT

Validation of rent control laws as constitutional on a mere showing that they have some rational basis will open the door to their use to accomplish transfers of wealth from landlords to tenants. Only by requiring the government to be prepared to prove that a given law will actually substantially advance a legitimate public purpose can private rental property owners be assured the protections of the Takings Clause.

Rent control is an extraordinary form of government economic regulation justifying a test of whether it substantially advances a legitimate government interest as opposed to whether there is a rational basis in order for the regulation to be held valid under the Takings Clause. Rent control always reduces the value of the regulated party's property. When tenants can transfer leasehold interests to third parties at controlled rents, the result is almost invariably a transfer of wealth from landlord to tenant; the reduction of the value of the landlord's property; and the creation of a premium for the tenant.

The reduction in value of the landlord's property alone, absent any other considerations, amounts to a taking. As such, the test of constitutionality should be whether the regulation substantially advances a legitimate governmental interest. Certainly, where not only the landlord's property value is reduced but a premium is created in the tenant (that is, where a transfer of wealth results from the governmental action between

private parties) the test of constitutionality should be the "substantially advances" test.

ARGUMENT

THE PROPER STANDARD OF REVIEW AS TO WHETHER A RENT CONTROL STATUTE MAY BE DEEMED A TAKING IN VIOLATION OF THE TAKINGS CLAUSE IS WHETHER IT SUBSTANTIALLY ADVANCES A LEGITIMATE GOVERNMENT INTEREST.

In dealing with recent efforts to establish rent control in Arizona, the MHCA has only needed to look west across the Colorado River to see what will happen. Like California, Arizona already has a state law creating the perpetual lease (i.e., ARS §33-1476(B) prohibits non-renewal of an expired mobile home lot lease without narrowly defined good cause and ARS §33-1452(D)-(3) allows the tenant to transfer his leasehold interest in the lot to third parties). Coupling this with a typical California type rent control law could be expected to produce a reduction in the value of the rental lot to the landlord/lot owner, and an increase in the value of the tenant owned mobile home occupying the lot beyond any intrinsic value in the home itself.[2] Common sense indicates that a tenant owning a mobile home on a rental lot not subject to limitations on future rent increases which then falls under government controls prohibiting or limiting future rent increases suddenly owns an asset with greater value, which can be realized when his rights are transferred to third parties.

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[2]Hirsch & Hirsch, *Legal-Economic Analysis of Rent Controls In a Mobile Home Context: Placement Values and Vacancy Decontrol*, 35 UCLA L.Rev. 399. This study examined 344 mobile home sales in 40 California cities, concluding that resale prices exceeded sales price of comparable homes by dealers in cities subject to rent controls.

In California, the result is that benefits for future tenants moving into mobile home parks with controlled below-market rents are offset by the higher prices they must pay to existing tenants to buy their mobile homes. There is, typically, marginal if any benefit to the public. The benefit is to tenants owning homes in mobile home parks at the time the rent control scheme is created. The values of their homes go up. This is offset by the detriment to the landlords who can no longer charge rent the market would otherwise permit. There is no public benefit to justify the harm to landlords.

That situation is similar to the instant case where the weight of the evidence established no public benefit resulting from government control of service station rents. Petitioners argue, however, that the courts have no business "second guessing" a legislative determination that there is a rational basis for the restrictions.

In *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), the Court established as a standard of review the "substantially advance" test when the statute at issue diminished a landowner's property rights and conferred rights in the landowner's property on private third parties. Most rent control ordinances have this effect, at least when the tenant's leasehold interest in transferable to other parties at controlled rents (the tenant, for purposes of *Nollan* being the third party receiving the rights transferred from the landlord).

This is the basis, in large part, for the Ninth Circuit's decision in the instant case.

In reviewing a California rent control ordinance which unquestionably accomplished a transfer of wealth from a rent controlled mobile home park landlord to the tenants owning mobile homes on its lots, the Court in *Yee*

v. City of Escondido, 503 U.S. 519 (1992), indicated that the "substantially advance" test was the correct standard. *Yee* indicates that not every loss of value to a property owner resulting from governmental rent control will qualify as a taking. To the extent it may constitute a taking, however, it will be treated as a regulatory taking.

It is clear that the standard for review of many, perhaps most economic regulations is the "rational basis" test. That is, the statute will be upheld so long as there is a rational basis for the legislature to conclude that the challenged law advances a legitimate purpose. This test is explained in *FCC v. Beach Communications, Inc.*, 508 U.S. 307 (1993), as one of determining "whether there is any conceivable rational basis justifying (the regulatory scheme) for purposes of the Due Process Clause of the Fifth Amendment". *Beach*, 508 U.S. at 309.

This "rational basis" test has been fairly characterized by one commentator as follows:

> The test of "rationality" is easy to pass: As long as any non-crazy legislator might plausibly believe – based on common speculation, or common sense instinct, with or without benefit of any social science or other data – that a law will make even a small dent in a social problem, the law survives review.

Vikram David Amar, *Rent Control in Hawaii Goes All the Way to the Supreme Court: An Interesting Takings Clause Challenge*, http://writ.news.findlaw.com/amar/-20041103.html.

Whether the government action has a rational basis may be a satisfactory standard when it comes to a review of zoning,[3] or a review of whether only licensed funeral

[3] *Schad v. Borough of Mount Ephraim*, 452 U.S. 61 (1981).

directors will be allowed to sell caskets.[4] But it is not a sufficient test when it comes to reviewing governmental action capping revenues generated by income producing properties thus reducing their values. This is especially true when the ultimate consequence is a transfer of wealth among private citizens.

Rent control can be popular and relatively easy to impose even in the absence of any legitimate justification:

> Polls of economists have found virtually unanimous agreement that declines in product quantity and quality are the usual effects of price controls in general. Of course there are not enough economists in the entire country for their votes to matter very much to politicians, who know that there are always more tenants than landlords and more people who do not understand economics than there are who do. Politically, rent control is often a big success however many serious economic and soeicl problems it creates.

Thomas Sowell, *Basic Economics: A Citizen's Guide to the Economy*, (Basic Books, 2000), page 29.

When the tenant is permitted to transfer the property with the rent unchanged or at least not "de-controlled", the practical effect is to take the landlord's value and give it to the tenant just as surely as if a physical part of the land was transferred. In fact, it's an even better deal for the tenant since in the typical rent control scheme, the landlord still has the duty to maintain the property.[5]

[4] *Craigmiles v. Giles*, 312 F.3d 220 (6th Cir. 2002).

[5] Walter Block, *Rent Control, The Concise Encyclopedia of Economics*, http://www.econlib.org/library/Enc/RentControl.-html, points out that while required to maintain the property,

[footnote continued]

Petitioners have analogized the action of the Ninth Circuit in the instant case to the so-called second guessing test espoused in *Lochner v. New York*, 198 U.S. 45 (1905). The rationale is that by applying the "substantially advance" standard in a rent control case, it follows that the same test will be applied in all cases involving economic regulation. This is not the case nor should it be.

Economic regulation cases are not a "one size fits all" situation. The MHCA certainly does not advocate the "substantially advance" test in all economic regulation situations. But where the effect of the regulation is a fundamental reduction in the value of the regulated party's property, or worse, an actual transfer of wealth from the regulated party (the landlord) to a specific beneficiary of the regulation (the tenant), the test under the Takings Clause should be whether it substantially advances a legitimate governmental interest. Such a distinction would avoid the perceived horrors of a return to the *Lochner* era.

Since the paramount purpose of a revenue producing property such as a mobile home park is establishing and collecting rent, any action by the government eliminating or reducing the owner's ability to do so is a taking of a fundamental property right. In a sense it is worse than taking title to the property since the owner is left with an undiminished obligation to continue to maintain the property.

Restricting this ability to generate revenue is a restriction quite different from other forms of economic regulation. While all have financial consequences and some

landlords frequently lack the means or incentive to do so due to inadequate income.

impact on property values, the imposition of rent control goes to the essence of ownership of rental properties. Landlords regard themselves as owning the right to an income stream, not a piece of land, and terminating or limiting that income stream in reality constitutes a taking of the value of what the owner has.

The Court should recognize this fundamental difference between laws regulating how much cash a revenue producing property is allowed to generate from other restrictions on how land may be used which may have economic consequences, even in cases in which there is no evidence of the creation of a premium in favor of a tenant. Whatever standard must be met in other economic regulation cases, the government should be put to the test of establishing that a rent control regulation substantially advances a legitimate government interest.

The Just Compensation Clause of the Fifth Amendment "represents a paradigmatic American privilege and immunity". Akhil Reed Amar, *The Bill of Rights: Creation and Reconstruction* (Yale University Press, 1998), page 268. By the time Congress drafted the Fourteenth Amendment, just compensation was almost universally considered a fundamental principle of justice. *Id.*

The legislative intent in this area underlying the Fourteenth Amendment was to overturn *Baron v. Baltimore*, 32 U.S. (7 Pet.) 243 (1833); to protect U.S. Citizens "whose property by state legislation had been wrested from them under confiscation". Amar, *The Bill of Rights, supra*, Page 268. This intent is hardly given effect by allowing a state to confiscate part of a revenue stream from an income producing property simply by showing that there may be some rational relationship of its action to a government interest.

Requiring the state to demonstrate that its action substantially advances a legitimate state interest does not constitute second-guessing of economic regulation. It simply puts the government to the task of establishing not only a compelling public purpose but that it will actually be served.

All rent control regulations reduce the value of the landlord's assets, and consequently they should be subject to the "substantially advances" test. But at the least, in those cases in which the evidence demonstrates the probability of a transfer of value from landlord to tenant meaning the tenant will receive a "premium" as the result of the regulation, the "substantially advances" test should apply.

The MHCA and the State of Arizona are at the entrance to a path leading to rent control. All parties need to know what standards Arizona must meet if it chooses to regulate rents. Can it control rents based on unsupported speculation that some worthwhile purpose will be served? Or must it be prepared to establish that the reduction in the landlord's property value and the creation of a premium for the tenant really advance a legitimate government interest.

CONCLUSION

Rent control violates the Takings Clause unless the regulation substantially advances a legitimate government interest.

Respectfully submitted,

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In The

Supreme Court of the United States

LINDA LINGLE, Governor of Hawaii, et al.

Petitioners,

v.

CHEVRON U.S.A., INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF HOME BUILDERS IN SUPPORT OF RESPONDENT

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With the joint written consent of the parties filed with the Clerk of the Court, the National Association of Home Builders (NAHB) respectfully submits this brief as *amicus curiae*.[1]

INTEREST OF *AMICUS CURIAE*

NAHB represents more than 215,000 builder and associate members throughout the United States. Its members include people and firms that construct and supply single family homes, as well as apartment, condominium, commercial, and industrial structures, land developers, and remodelers. It is the voice of the American shelter industry. It is — and historically has been — vitally concerned with judicial decisions dealing with government regulation of property, with a particular interest in this Court's interpretation and application of the 5th Amendment.

NAHB has appeared before the Court as an *amicus curiae* or "of counsel" to property owners in a number of cases involving the rights and remedies of those adversely affected by governmental actions. These began with the case that has become the focal point at bench, *Agins v. City of Tiburon*, 447 U.S. 255 (1980), and continued with *San Diego Gas & Elec. Co. v. City of San Diego*, 450 U.S. 621 (1981); *Williamson County Reg. Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985); *MacDonald, Sommer & Frates v. Yolo*

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[1] Counsel for *amicus curiae* authored this brief in whole and no other person or entity other than *amicus*, its members or counsel have made a monetary contribution to the preparation or submission of this brief.

County, 477 U.S. 340 (1986); *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987); *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987);[2] *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Babbitt v. Sweet Home Chapter of Communities for a Great Or.*, 515 U.S. 687 (1995); *Suitum v. Tahoe Reg. Planning Agency*, 520 U.S. 725 (1997); *City of Monterey v. Del Monte Dunes*, 526 U.S. 687 (1999); *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001); *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Engineers*, 531 U.S. 159 (2001); *Tahoe-Sierra Preservation Council v. Tahoe Reg. Planning Agency*, 535 U.S. 302 (2002); *Borden Ranch P'Ship v. U.S. Army Corps of Engineers*, 537 U.S. 99 (2002); *City of Cuyahoga Falls v. Buckeye Cmty. Hope Found.*, 538 U.S. 188 (2003); *S. Fla. Water Mgmt. Dist. v. Miccosukee Tribe of Indians*, 124 S. Ct. 1537 (2004) and *Kelo v. City of New London*, 843 A.2d 500 (Conn. 2004), *cert. granted*, 125 S.Ct. 27 (2004).

SUMMARY OF ARGUMENT

1. This Court's decision in *Agins v. City of Tiburon*, 447 U.S. 255 (1980), plainly held that a 5th Amendment taking of property occurs when a regulation fails to substantially advance a legitimate state interest, contrary to the repeated assertions of Petitioners and their *amici*, who insist that it was mere dictum. In *Agins*, the Court first described its two-pronged alternative test for regulatory takings and then held that the city's regulation substantially advanced a legitimate state interest, thus eliminating any need to determine whether there was any adverse economic impact. It has become a regulators' fiction, a modern urban myth, to describe the test as "dictum," but the regulators' position is nonetheless fiction. The test was an integral part of the Court's holding. Eliminating one of the test's two prongs would require overruling *Agins* and, at least in part, *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978), a result that would be as unfortunate for takings jurisprudence as it would be out of pattern with the Court's other decisions.

2. There is no basis for the Petitioners' charge that the *Agins* formulation was the result of this Court's "confusion" between takings and due process doctrine. Rather, as this Court's later opinions fleshed out, there is a substantial relationship between takings and due process that sometimes makes them resemble each other. The Court, for example, has explained that the breadth of the eminent domain power is "coterminous" with the scope of the police power, although the former is reviewed under the Takings Clause and the latter under the Due Process Clause.

The relationship between the two powers may be most clearly seen in the "public use" restriction on the power of eminent domain (otherwise an inherent power of government). If a deliberate attempt to exercise eminent domain is found not to be for a public use, then

[2] The Court's opinion cited NAHB's brief. (483 U.S. at 840.)

the taking is enjoined as invalid.[3] In similar fashion, if a regulation fails to substantially advance a legitimate state interest, it is also enjoined as invalid (with compensation for any temporary taking that occurred while the invalid regulation was enforced). Both theories operate under, and are judged by, the Takings Clause.

3. The real crux of the regulators' position here is not whether their actions are challenged under a taking theory or a due process theory, but what standard of review is applied. Regardless of the constitutional theory, they want a standard of review that is so deferential as to be a virtual rubber stamp. That does not fit with this Court's settled jurisprudence nor with this Nation's development.[4]

In order to vindicate the 5th Amendment's protection of the rights of private property owners, it is essential that the judiciary engage in an elevated form of review, something that will actually ensure that the Takings Clause is effectuated, not merely mouthed.

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[3] The public use issue is currently before the Court in *Kelo v. City of New London*, no. 04-108, set for oral argument the same day as this case.

[4] They have perhaps lost sight of the fact that our forebears revolted against the British because they had no real ability to have substantial regulatory review. (Events like the Boston tea party come to mind.)

I

AGINS ESTABLISHED ITS RULE BY HOLDING, NOT BY DICTUM, AND THE COURT HAS HEWED TO IT EVER SINCE.

The strange governmental premise at bench is that the regulators are merely asking the Court to clear away a bothersome "dictum" that has never formed a holding of the Court. (E.g., Lingle 25.) That is a false premise.[5] In opinions authored by a variety of Justices, the Court has regularly applied the test.

In *Agins*, the Court laid down the rule for evaluating regulatory taking claims (447 U.S. at 260) and then *applied* that rule *by holding* that the city had met the standard: "the zoning ordinances substantially

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[5] The Solicitor General's repetition of this argument (US 24) is particularly troublesome. The arguments of that office are rightly respected by this Court. But the Solicitor General never questioned the validity of the *Agins* formulation before its *amicus* brief in *City of Monterey v. Del Monte Dunes*, 526 U.S. 687 (1999) (as NAHB demonstrated in its own amicus brief in that case, pp. 16-17, fn. 5) and this Court refused to consider the argument there. Indeed, even in this case, the Solicitor General concedes that the Court upheld the regulation in *Agins* because it "*did* 'substantially advance legitimate governmental goals . . . ." (US 24, fn. 14; emphasis in original), plainly denoting a holding. So why attack the rule as "dictum" when it clearly was not and the Solicitor General knows it was not?

advance legitimate governmental goals." (447 U.S. at 261 [Powell, J.].) That was not dictum; it was *ratio decidendi*.

Thereafter, in *Hodel v. Irving*, 481 U.S. 704, 718 (1987), the Court struck down a federal statute, holding it went "too far" because its proper purpose would not always be advanced by its application. ([O'Connor, J.].)[6]

In *Nollan*, this Court again applied the standard and held that the California Coastal Commission had failed the test of advancing the public purpose and therefore its permit condition was invalid. (483 U.S. at 837 [Scalia, J.].)

In *Andrus v. Allard*, 444 U.S. 51 (1979), the Court began its analysis of the constitutionality of the Eagle Protection Act by concluding that its terms reasonably advanced its purposes (444 U.S. at 57-58 [Brennan, J.]), presaging *Agins* and using the same kind of Takings Clause analysis to uphold the statute.

In *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470, 485 (1987), the Court summarized the rule this way: "We have *held* that land use regulation can effect a taking if it 'does not substantially advance legitimate state interests. . . .' [Citing *Agins*.]" (Emphasis added [Stevens, J.].)

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[6] Congress' later attempt to "fix" the statute was struck down for the same reasons. (*Babbitt v. Youpee*, 519 U.S. 234 [1997] [Ginsburg, J.].)

In *Del Monte Dunes*, a property owner proved at trial that "none of the City's stated reasons for denying its application was sufficiently related to the City's legitimate interests." (*Del Monte Dunes at Monterey v. City of Monterey*, 95 F.3d 1422, 1430 [9th Cir. 1996], *aff'd sub nom. City of Monterey v. Del Monte Dunes*, 526 U.S. 687 [1999].) The evidentiary clash is discussed in detail in the Court of Appeals' opinion (95 F.3d at 1430-1432), and noted with this Court's comment that the owner "submitted evidence *designed to undermine the validity of the asserted factual premises* for the city's denial of the final proposal. . . ." (526 U.S. at 699; emphasis added [Kennedy, J.].)[7]

More recently, in *Tahoe-Sierra Preservation Council v. Tahoe Reg. Plan. Agency*, 535 U.S. 687 (2002), the Court reiterated that considerations of "fairness and justice" could require relief under the Takings Clause if a regulation "did not substantially advance a legitimate state interest." (535 U.S. at 334 [Stevens, J.].) In support, the Court cited both *Agins* and *Del Monte Dunes*.

The "substantially advance" theory is an embedded part of Takings Clause jurisprudence. The

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[7] *Del Monte Dunes* was a 5-4 decision on the 7th Amendment issue of whether liability should have been decided by judge or jury, but the four dissenters agreed that a decision on the validity of the city's action was appropriate for trial under the Takings Clause. The only disagreement was on the question of who made that ultimate decision. (See 526 U.S. at 755, fn. 14.)

Court has used it to uphold regulations (*Agins*, *Andrus*), to strike down regulations (*Nollan*, *Hodel*), to uphold a compensatory award (*Del Monte Dunes*) and has referred to it repeatedly (e.g., *Keystone*, *Tahoe-Sierra*). Calling it dictum doesn't change those facts.

II

TAKINGS AND DUE PROCESS ARE DIFFERENT THEORIES. THERE IS NEED AND ROOM FOR BOTH IN EVALUATING THE PROPRIETY OF REGULATIONS.

The regulators assert that this Court was "mistaken" and "confus[ed]" about takings and due process when it established *Agins*' two part disjunctive test for a regulatory taking. (Lingle 23, 28.) NAHB demurs. The Court plainly recognized a proper sphere for each theory, and the relevance to the Takings Clause of both substantial advancement of legitimate interests and economic impact.

A

Economic Impact Has Never Been The *Sine Qua Non* Of The Takings Clause.

Agins was decided shortly after *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978) — and *Penn Central* is recognized as the polestar of this Court's modern takings jurisprudence. (E.g., *Tahoe-Sierra Preservation Council v. Tahoe Reg. Plan. Agency*, 535 U.S. 302, 327, fn. 23 [2002]; *Palazzolo v. Rhode Island*, 533 U.S. 606, 633 [2001].)

In laying out the proper mode of analysis for regulatory taking cases, this Court made clear that there were many factors to be considered, and economic impact was merely one of a group of factors to consider in what must be "essentially ad hoc, factual inquiries." (*Penn Central*, 438 U.S. at 124.)

Thus, when *Agins* held that either economic impact or failure to substantially advance legitimate state interests would suffice to invoke the protection of the Takings Clause, it was merely amplifying what the Court established in *Penn Central* two years earlier. Later cases continued that development.

In *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), a case challenging a New York statute authorizing the installation of cable TV in apartment buildings over the owners' protests, the Court found a taking regardless of the fact that the amounts involved were *de minimis*.

In *Hodel v. Irving*, 481 U.S. 704 (1987), a case challenging a congressional scheme to escheat miniscule estates of Native Americans in order to reduce the government's administrative costs, the Court found a taking regardless of the fact that the property interests involved were worth less than $100 each. (See also *Babbitt v. Youpee*, 519 U.S. 234 [1997] [amended statute struck down in similar fashion].)

In *Dolan v. City of Tigard*, 512 U.S. 374 (1994), the Court found that conditions to a land use permit amounted to a taking because they were not "roughly proportional" to the projected impact of the proposed development. A taking was found even though Mrs. Dolan "assuredly [was] able to derive *some* economic use from her property." (512 U.S. at 385, fn. 6; emphasis, the Court's.)

In short, although economic impact *can* be an important factor in regulatory takings, it is not the *sole* — or even determinative — factor. It never was.

B

A "Substantial Advancement" Analysis Is Not The Sole Province Of The Due Process Clause.

At the heart of the regulators' substantive argument is the neo-*Lochner*ian notion that "failure to substantially advance a legitimate state interest" is "really" a substantive due process standard, rather than a takings standard. (Lingle 23.)

But the *Agins* formulation fits with this Court's consistent view of regulatory takings as well as its view of the relationship of substantive due process to the enumerated protections in the Bill of Rights.

First, since *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922), the Court's regulatory taking law has been premised on the concept that a taking occurs when an exercise of the police power goes "too far." All of the

Court's subsequent regulatory takings jurisprudence has explicated the meaning of "too far" and described how one draws that line. But the only way to determine that answer is to examine the regulatory action and determine precisely what it does and how it does it. (*Hughes v. Washington*, 389 U.S. 290, 298 [1967]; Stewart, J., concurring. See also *San Diego Gas & Elec. Co. v. City of San Diego*, 450 U.S. 621, 652-653 [1981]; Brennan, J., dissenting but apparently expressing the substantive view of a majority of the Court [see 450 U.S. at 633-634; Rehnquist, J., concurring].)

Plainly, one of the ways in which government regulators can go "too far" is by enacting regulations thought to be in the public interest but which, in fact, fail to substantially advance that interest.[8]

> "*Pennsylvania Coal* instructs courts to examine the operative provisions of a statute, not just its stated purpose, in assessing its true nature. In *Pennsylvania Coal*, that inquiry led the Court to reject the Pennsylvania Legislature's stated purpose for the statute . . . ." (*Keystone*, 480 U.S. at 487, fn. 16.)

Justice Stevens analyzed the Court's application of the Takings Clause in *Pennsylvania Coal* this way:

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[8] Shortly after *Pennsylvania Coal*, the Court struck down another regulation as a taking because the government lacked a proper regulatory purpose. (*Delaware, Lackawana & Western Ry. Co. v. Morristown*, 276 U.S. 182, 195 [1928].)

> "In his opinion for the Court, Mr. Justice Sutherland *fused the two express constitutional restrictions on any state interference with private property* — that property shall not be taken without due process nor for a public purpose without just compensation — into a single standard." (*Moore v. City of East Cleveland*, 431 U.S. 494, 514 [1977]; Stevens, J., concurring.)

Thus, in Justice Stevens' view, the East Cleveland ordinance in *Moore* was invalidated *as a taking* because analysis showed there was no justification for the ordinance. (431 U.S. at 520.)

In *San Diego Gas*, Justice Brennan's nominally dissenting opinion concluded that California's courts had contradicted this Court's clear precedents by holding that "a city's exercise of its police power, however arbitrary or excessive, cannot as a matter of law constitute a 'taking' within the meaning of the Fifth Amendment." (450 U.S. at 647.)[9]

In *Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229, 240 (1984), Justice O'Connor explained for the Court that "the 'public use' requirement is . . . coterminous with the scope of a sovereign's police powers." Justice O'Connor amplified this thought in *Yee v. City of Escondido*, 503 U.S. 519, 530 (1992), a case challenging rent control regulations as a taking of property, concluding that a regulatory taking depends on "whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." Justice O'Connor then returned to this theme more recently in *Palazzolo*, showing how "[t]he first question" in a takings analysis is whether "application of a regulation constitutes a valid exercise of the police power." (533 U.S. at 636; O'Connor, J., concurring.)

In *Berman v. Parker*, 348 U.S. 26, 31 (1954), the Court evaluated "public use" in a direct condemnation case by noting that "[w]e deal, in other words, with what traditionally has been known as the police power."

As the Solicitor General put it in his *amicus curiae* brief in this case:

> "[I]ndeed the 'public use' requirement would be a proper basis under the Just Compensation Clause for any examination parallel to that under the Due Process Clause of whether the governmental action could rationally be expected to advance a legitimate public purpose." (US 22, fn. 10.)

In other words, the Takings and Due Process Clauses are not separated in hermetically sealed containers, as the regulators would have it. Rather, they are closely related — "fused," to use Justice Stevens'

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[9] Justice Brennan's view became the basis for the Court's decision in *First English*, which cites the Brennan dissent repeatedly and tracks its analysis.

word, or "coterminous," to borrow Justice O'Connor's.[10] A regulation that goes "too far," like the Hawaii statute at bench, violates the Takings Clause, regardless of any due process analysis. (*Nollan*, 483 U.S. at 835, fn. 3.) As the polestar *Penn Central* opinion put it, "a use restriction may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial government purpose." (438 U.S. at 127.)[11]

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[10] Scholars have long understood this, denigrating attempts to segregate the two powers. See, e.g., Waite, *Governmental Power and Private Property*, 16 Cath. U.L. Rev. 283, 292 (1967) ("illusory"); Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 Harv. L. Rev. 1165, 1186 (1967) ("wordplay"); Van Alstyne, *Taking or Damaging by Police Power: The Search for Inverse Condemnation Criteria*, 44 S. Cal. L. Rev. 1, 2 (1971) ("circular reasoning, and empty rhetoric").

[11] The Petitioners' attempt to deconstruct the word "substantial" (Lingle 47) is unconvincing. Plainly, the Court meant something by its use. The assertion that the word is "ambiguous" seems disingenuous. As the Court itself explained in *Nollan*, the word means more than the rational basis concept of due process cases. (483 U.S. at 834-835, fn. 3.) Acknowledging the *Nollan* analysis but describing it as "tentative" and said "in passing" (Lingle 48) does not further the inquiry. It is plain from a reading of the cases discussed in the text that the word has not been used casually and was, instead, intended to have meaning.

Thus, under *Penn Central*, it is not enough to say that a regulation is "reasonable" or has a "rational basis." That may be the issue under the Due Process Clause, but it is not the issue under the Takings Clause. Takings analysis requires examination of the necessity for the regulation as well (*Penn Central*, 438 U.S. at 127) and, accordingly, whether the regulation will actually accomplish its stated goals. And it requires that determination to be made on an "ad hoc" basis. The Court's requirement of ad hoc inquiry to determine Takings Clause liability has not been restricted to *Agins'* second prong, but has been a uniform requirement. (See *Penn Central*, 438 U.S. at 124; *Kaiser Aetna v. U.S.*, 444 U.S. 164, 175 [1979]; *San Diego Gas*, 450 U.S. at 649-650 [Brennan, J., dissenting]; *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 [1982]; *MacDonald, Sommer & Frates v. Yolo County*, 477 U.S. 340, 349 [1986]; *Keystone*, 480 U.S. at 474, 495; *Hodel*, 481 U.S. at 714; *Lucas*, 505 U.S. at 1015.)[12]

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[12] Some of the cases cited above involved as-applied challenges, others were facial; some involved regulatory takings, others were physical; some involved development denials, others conditions on development; some involved 42 U.S.C. § 1983, others did not; some were from state courts, others federal. But they *all* concerned Takings Clause challenges and they *all* required factual examination of the regulatory action to determine its validity. Indeed, this factual requirement pre-dates the Court's takings decisions during the last few decades. (See *Pennsylvania Coal*, 260 U.S. at 413; *Berman v. Parker*, 348 U.S. 26, 32 [1954].)

In *Lucas*, 505 U.S. at 1030, the Court mandated a "total takings inquiry" into a case's facts and background circumstances using the *Penn Central* rationale, except for those few cases that would fit within the *per se*, or categorical, takings categories.

Lower courts have followed *Penn Central*'s lead in examining the "necessity of regulation" under a Takings Clause analysis:

> "In short, has the Government acted in a responsible way, limiting the constraints on property ownership to those *necessary to achieve the public purpose*, and not allocating to some number of individuals, less than all, a burden that should be borne by all?" (*Florida Rock Indus., Inc. v. U.S.*, 18 F.3d 1560, 1571 [Fed. Cir. 1994]; emphasis added.)

Second, perhaps wary of resurrecting *Lochner v. New York*, 198 U.S. 45 (1905), the Court has not looked favorably on actions that would expand the reach of substantive due process. (See, e.g., *Collins v. Harker Heights*, 503 U.S. 115, 125 [1992] ["the Court has always been reluctant to expand the concept of substantive due process because the guideposts for responsible decisionmaking in this uncharted area are scarce and open-ended"].)

To restrict the reach of substantive due process, *Graham v. Connor*, 490 U.S. 386 (1989) holds that, where a claim can be brought under one of the separately stated Bill of Rights guarantees, there is no

substantive due process claim. Some lower courts have interpreted *Graham* to preclude property owners from suing on substantive due process grounds because the Takings Clause provides an adequate constitutional remedy. (E.g., *Armendariz v. Penman*, 75 F.3d 1311, 1318-1320 [9th Cir. 1996] [en banc]; *South County Sand & Gravel v. Town of South Kingstown*, 160 F.3d 834, 835 [1st Cir. 1998]; *Bateman v. City of West Bountiful*, 89 F.3d 704, 709 [10th Cir. 1996].)

The regulators' briefs say they want to reverse all that and increase the volume of substantive due process litigation. What they really want, as briefed *post*, pp. 24-29, is a lessened standard of review for their actions.

Beyond that, other than a cursory mention in the Petitioner's procedural summary (Lingle 4), the regulators' briefs fail even to acknowledge, much less account for, the fact that this constitutional challenge was brought under 42 U.S.C. § 1983.

The use of Section 1983 makes a difference. Ignoring it allows the regulators to argue that failure to advance a legitimate state interest *cannot* be a takings theory because there can be no taking without proper governmental action. (Lingle 18-19; US 22.) But Section 1983 alters that. Actions under that section are brought because of a "[m]isuse of power, possessed by virtue of state law and made possible only because the wrongdoer is clothed with the authority of state law . . ." (*Monroe v. Pape*, 365 U.S. 167, 184 [1961].) That statute was enacted to protect citizens against violations of their constitutional rights under color of state law,

including the specific problem of Takings Clause violations. (*Monell v. Department of Social Services*, 436 U.S. 658, 685-687 & fn. 45 [1978].)

Thus, in the context of Section 1983, the "substantial advancement" prong of *Agins* can be used in cases where regulations have already been invalidated to show the need for temporary taking compensation. The failure to substantially advance a legitimate state interest part of the takings rationale goes beyond due process and establishes liability in these circumstances.

C

The Regulators Over-Read The Court's Decision in *First English*.

The regulators' position is based largely on an over-reading of *First English*, asserting that it established compensation as the only remedy for a Takings Clause violation, thus showing that the analysis used below properly belongs to the Due Process Clause. (Lingle 18, 19, 22; US 17-22.)

While it is true that *First English* answered a question which had plagued courts for years, by concluding that the Takings Clause prohibits states from holding that compensation may *not* be awarded for regulatory takings of property, the Court did *not* hold that compensation is the *only* remedy available to Takings Clause victims. Other cases decided contemporaneously with *First English* (as well as *First English* itself) make this clear. (See *Keystone*, 480 U.S.

470; *Hodel*, 481 U.S. 704; *Nollan*, 483 U.S. 825.)

In *Keystone*, the first of 1987's multiple Takings Clause cases, the Court was faced with a challenge to the constitutionality of a statute requiring coal companies to leave a sufficient amount of coal in the ground to preclude subsidence, effectively prohibiting the mining of a substantial amount of coal. The coal companies sought injunctive relief. The important thing about *Keystone* is not *that* the Court upheld the statute, but the *way* it did so: the *merits* of the coal companies' arguments were painstakingly examined. If the *only* remedy for a regulatory taking were compensation, then the Court's opinion needed to be only one paragraph long. It could have dismissed the case on the ground that it sought the wrong remedy. But it did not. And *First English* was under active consideration at the time, having been argued less than two months before the *Keystone* opinion was filed.

Hodel was decided two months after *Keystone*. It tested the constitutionality of a federal statute designed to halt the intense fractionalization of Native American lands by prohibiting the transfer at death of miniscule estates. By statute, such estates would escheat to the appropriate tribe. There was no question about the public purpose of the statute, but the Court held it went too far. The statute was struck down, this time less than a month before *First English* would be filed.

First English itself talks of invalidating regulations that violate the Takings Clause. (See 482 U.S. at 317, 319, 320, 322.) Compensation is an

additional remedy to compensate for the temporary taking occurring between adoption of the regulation and its ultimate invalidation. (482 U.S. at 321.)

Then, two weeks after it decided *First English*, the Court decided *Nollan*. There, the property owners sought a writ of mandate to invalidate a condition attached to a development permit. No compensation was sought. With *First English* freshly on the books, the Court concluded that the permit condition effected a taking and turned to the remedy sought by the property owners. The Court granted the only relief sought, i.e., injunctive. If, as the regulators argue here, the only remedy for a taking is compensation, then the Court had no business granting some other form of relief.

Plainly, this Court's series of 1987 cases demonstrates that there is no single remedy under the Takings Clause. Injunctive relief against excessive regulation is not the sole province of the Due Process Clause. Depending on the facts, either monetary relief or injunctive relief may be appropriate. Here, in an application of *Agins*' first prong, the courts below determined that injunctive relief was the proper Takings Clause remedy on these facts. Because the economic impact of the regulation was not at issue, that result was both authorized and justified.[13]

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[13] As no compensation was sought, the case was properly filed in U.S. District Court without "ripening" under *Williamson County Reg. Plan. Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985). The operation of the *Williamson County* rule has been heavily criticized,

III

A MERE GOVERNMENTAL STATEMENT THAT REGULATION IS UNDERTAKEN TO ADVANCE THE PUBLIC INTEREST CANNOT BE ACCEPTED ON FAITH. REAL JUDICIAL INQUIRY IS REQUIRED.

Reviewing the constitutionality of legislative acts is neither to be sought nor taken lightly. However, such review is a necessary part of our constitutional system. As this Court explained, such review is undertaken:

> ". . . with all respect for the powers of Congress, but with recognition of the transcendent status of our Constitution." (*Kennedy v. Mendoza-Martinez*, 372 U.S. 144, 159 [1963].)

Whether legislative action complies with the Constitution is a question for the judiciary — and has been since *Marbury v. Madison*, 1 Cr. 137 (1803).

A

The Bill of Rights Was Designed To Restrict The Power of Government. This Court Has Consistently Applied That Restriction Under The Takings Clause.

As Justice Holmes explained for the Court in its first regulatory taking case of the 20th century, "[t]he

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and will be reviewed later in the Term in *San Remo Hotel v. City and County of San Francisco*, No. 04-340.

greatest weight is given to the judgment of the legislature, *but it always is open* to interested parties to contend that the legislature has gone beyond its constitutional power." (*Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 [1922].)[14]

The problem is that the regulators refuse to recognize limits; they seek virtually unreviewable deference. With respect, as this Court recently held in *Del Monte Dunes*, 526 U.S. 687, that position is untenable. In *Del Monte*, the city and its *amici* protested against judicial "second-guessing" of regulatory decisions under the first prong of *Agins*, asking for the same kind of abject deference sought at bench. The Question Presented by the city was this:

> "Whether liability for a regulatory taking can be based upon a standard that allows a jury or court to *reweigh evidence concerning the reasonableness* of the public entity's land use decision." (Petition, p. i; emphasis added.)

This Court's response was crisp and clear:

> "To the extent the city argues that, as a matter of law, its land-use decisions are immune from judicial scrutiny under all circumstances, its position is contrary to settled regulatory takings principles. We reject this claim of error." (*Del Monte Dunes*, 526 U.S. at 707.)

Del Monte was a continuation of the Court's modern regulatory taking decisions. In *First English*, the Court concluded that compensation is an available remedy for a regulatory taking. The defendant county and its many *amici* had voiced fears that a governmental loss would cripple government's ability to govern. The Court rejected that hyperbolic plea, concluding that "many of the provisions of the Constitution are designed to limit the flexibility and freedom of governmental authorities . . . ." (482 U.S. at 321.)

Indeed, one might say that the entire purpose of the Bill of Rights is to restrict the exercise of governmental power.[15]

Two weeks after *First English*, the Court amplified its insistence that the protection afforded the rights of property owners be enforced, not evaded: "We view the Fifth Amendment's Property Clause to be more than a pleading requirement, and compliance with it to be more than an exercise in cleverness and imagination." (*Nollan*, 483 U.S. at 841.)

As shown below, the Court's decisions under the Takings Clause have enforced this choice of protection

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[14] See also *Winger v. Aires*, 89 A.2d 521, 522 (Pa. 1952) (enjoining use of eminent domain as unnecessary): "The genius of our democracy springs from the bedrock foundation on which rests the proposition that office is held by no one whose orders, commands or directives are not subject to review."

[15] As Justice Douglas put it, "The Constitution and the Bill of Rights were designed to get Government off the backs of the people — all the people." (Quoted in Hentoff, Living the Bill of Rights 2 [1998].)

over inventive wordplay. Accepting the regulators' arguments at bench, and subjecting their actions only to minimal review, will undo the protection intended by the Constitution and enforced by the Court until now.

B

An Elevated Level Of Judicial Scrutiny Is Necessary To Vindicate The Protection Intended By The Takings Clause.

Candor is necessary. What the regulators are really complaining about is the standard of review (eventually discussed late in the Petitioners' brief [Lingle 37]). The theory under which review is made cannot be divorced from its standard of review. Indeed, the labeling process is otherwise meaningless: it would make no difference which constitutional violation was charged if the standard of review were the same.

What the regulators seek is to evade the heightened scrutiny for regulatory takings established in cases like *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 834, 841 (1987).[16] Instead, they want to

[16] The regulators' briefs concede that *Nollan* and its eventual companion *Dolan* are fully applicable to property exactions attached as conditions to permits (Lingle 33; US 28), but seek to evade any *Nollan/Dolan* analysis by saying that those cases involve a special rule applicable only to such permit conditions.

They are right about the continuing validity of *Nollan* and *Dolan*, but wrong about their application

beyond the exaction context. First, nowhere in either case — or in *Agins* or *Penn Central*, for that matter — did the Court hold that the substantial advancement test required land dedication. To the contrary, in *Ehrlich v. City of Culver City*, 512 U.S. 1231 (1994), involving development fees, the Court issued a writ of certiorari, vacated the state court judgment, and remanded the matter for consideration in light of *Dolan*, which had just been decided. Ultimately, the California Supreme Court agreed with this Court and applied the *Nollan/Dolan* analysis to a purely monetary issue. (*Ehrlich v. City of Culver City*, 911 P.2d 429 [Cal. 1996], *cert. den.*, 117 S. Ct. 299 [1996].)

Second, their reliance on *Del Monte Dunes* (Lingle 32; US 27) is misplaced. There, this Court dealt with *Dolan*'s "rough proportionality" component, not the *Nollan/Agins* issue of "substantial advancement." In that context, the Court said that it had not yet applied the rough proportionality test beyond the exaction context (526 U.S. at 702), but never said that it would be improper to do so. In any event, assuming that the rough proportionality concept is restricted to exactions, nothing in the Court's jurisprudence suggests that the entire first prong of *Agins* is so restricted.

Third, both before and after *Del Monte Dunes*, the Court has stressed the proper role of proportionality analysis in judging the validity of legislative responses to perceived problems. (See *U.S. v. Vajakajian*, 524 U.S. 321, 324 [1998]; *Florida Prepaid Postsecondary Ed. Expense Bd. v. College Savings Bank*, 527 U.S. 627,

substitute due process, whose standard they gloss over as "rational basis" (US 21, fn. 9), i.e., that a regulation is acceptable if there is some rational basis for it that can be conjured up by a court after the fact, regardless of whether anyone who voted on the regulation ever considered it at all. (E.g., *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 466 [1981].)

But that is not an accurate picture of due process as it is applied in land use cases. Property owners have not even had that loose standard applied to their claims.

The 1st Circuit, for example, has held that substantive due process is virtually unavailable in land use disputes, saying it has only "left the door *slightly ajar* for federal relief in *truly horrendous situations*. But . . . the threshold for establishing the requisite 'abuse of governmental power' is a *high one* indeed." (*Nestor Colon Medina & Sucesores, Inc. v. Custodio*, 964 F.2d 32, 45 [1st Cir. 1992]; emphasis added.)[17]

The 3d Circuit applies a "shocks the conscience" standard (*United Artists v. Township of Warrington*, 316 F.3d 392, 400 [3d Cir. 2003]),[18] even though that standard devolved from police actions like *Rochin v. California*, 342 U.S. 165 (1952) (forced stomach pumping) and *County of Sacramento v. Lewis*, 523 U.S. 833 (1998) (high speed car chase through residential neighborhood), which had nothing to do with the more carefully thought out economic and land use regulations dealt with in cases like this.

Thus, the regulators' desire to be thrown into the briar patch of substantive due process (a desire unthinkable for regulators in the *Lochner* era) comes from an evident wish to slide into a form of judicial review that is exceedingly regulator-friendly.[19]

This Court is already on record as seeing "no reason why the Takings Clause of the Fifth Amendment,

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646 [1999].) Thus, nothing in *Del Monte Dunes* or any other of this Court's cases suggests that there is no need for a close nexus between regulatory means and ends. Quite the contrary.

[17] The 2d Circuit has been called "even more hostile" to such property owner claims than the 1st. (*Pearson v. City of Grand Blanc*, 961 F.2d 1211, 1218 [6th Cir. 1992].)

[18] The validity of the 3d Circuit's standard is the subject of Petitions for Certiorari this Term in *Lindquist v. Buckingham Township*, No. 04-681 and *Levin v. Upper Makefield Township.*, No. 04-500, *cert den.*, 73 U.S.L.W. 3248 (Dec. 13, 2004).

[19] Professor Eagle has urged that, if the Court were to enforce a standard of "*meaningful* substantive due process" (Eagle, Regulatory Takings, § 12-2, p. 977 [2d ed. 2001]; emphasis added), i.e., review with a heightened level of actual scrutiny, then such a standard might provide appropriate constitutional protection. But that would require more than "rational basis" review and would certainly not subject property owners to the standards discussed above.

as much a part of the Bill of Rights as the First Amendment or the Fourth Amendment, should be relegated to the status of a poor relation . . . ." (*Dolan v. City of Tigard*, 512 U.S. 374, 392 [1994].) The Court, in furtherance of that protection for property owners, has expressly refused to apply "rational basis" scrutiny to Takings Clause cases. (*Dolan*, 512 U.S. at 391.)[20]

If the first prong of *Agins* is eliminated, the rights protected by the Takings Clause will become poor relations, indeed. If regulators need do no more than appear in court and suggest possible reasons that might have supported their regulations, then the regulators will always prevail. That's not a rule of law, but an imperial ukase that ill serves our Constitution. As the Court put it, "such a justification can be formulated in practically every case" making review of even expressly stated regulatory intentions "a test of whether the legislature has a stupid staff." (*Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1025, fn. 12 [1992].)

That is why the Court was quite explicit when it remanded *Lucas* so the State could defend its legislation. The Court "emphasized[d] that to win its case, South Carolina must do more than proffer the legislature's declaration . . . or its conclusory assertion . . . ." (*Lucas*, 505 U.S. at 1031.) *A fortiori*, if the legislature's actual

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[20] The reason for that should be apparent: a regulation can be perfectly "rational" or "reasonable" but still not advance legitimate state interests one iota and may, in fact, be counterproductive. (See, e.g., *Hodel v. Irving*.) The courts below found that to be the case here.

formulation of a supposed justification is insufficient to validate legislation challenged under the Takings Clause — unless supported by facts produced at trial — then conjectured rationalizations under a "rational basis" review should not suffice either.

Reliance on *U.S. v. Carolene Prods.*, 304 U.S. 144 (1938) (Lingle 38; Govt. Organizations 10) overlooks that opinion's express recognition that any presumption of regulatory regularity is "narrower . . . when legislation appears on its face to be within a specific prohibition of the . . . first ten amendments." (304 U.S. at 152, fn. 4.) That is this case.

The ultimate goal in a takings inquiry is "to bar Government from forcing some people alone to bear public burdens which in all fairness and justice, should be borne by the public as a whole." (*Armstrong v. U.S.*, 364 U.S. 40, 49 [1960].) The way to achieve that goal is for a court to scrutinize the burden imposed on the property owner and measure, as *Penn Central* instructs (438 U.S. at 127), whether the means chosen are necessary to the desired end, and whether they will achieve that end.

CONCLUSION

The Takings Clause standard being challenged here is one that this Court has applied and discussed for decades. It has consistently inquired whether regulations "substantially advance a legitimate state interest," upholding some while striking down others.

The standard has worked well, allowing (as in *Del Monte Dunes*) an impartial examination of the workings of a regulatory scheme to determine whether it has the capacity to accomplish its goals or whether, in the alternative, it is an unnecessary imposition on the property owner (as the Court instructed lower courts to investigate in *Penn Central*).

The major item of concern in this case is not the legal theory of liability, but the standard of review of governmental action. The positions are starkly laid out. The regulators want virtual free rein, under a standard that — in the Court's words — only "a stupid staff" could fail to satisfy. Property owners, by contrast, ask for a standard that allows them to demonstrate a regulation's constitutional failure.

NAHB prays that the decision be affirmed, with an opinion explaining the continuing vitality of the *Agins* formula for enforcing the Takings Clause.

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IN THE

Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and MARK J. BENNETT, Attorney General of the State of Hawaii,
Petitioners,

v.

CHEVRON USA, INC.
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL GOVERNORS ASSOCIATION, COUNCIL OF STATE GOVERNMENTS, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL LEAGUE OF CITIES, U.S. CONFERENCE OF MAYORS, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, AND INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION AS *AMICI CURIAE* SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether a court may invoke the Just Compensation Clause to resurrect heightened scrutiny and invalidate state economic legislation through de novo second-guessing of the State's judgment as to the law's wisdom and efficacy.

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INTEREST OF THE *AMICI CURIAE*

Amici's members include state and local governments and officials throughout the United States.[1] These officials design, enact, and implement a broad array of health, safety, land use, and other economic regulations to promote the public good. *Amici* thus bring a vital perspective to regulatory takings challenges to these protections, and have submitted friend-of-the-court briefs to this Court in many takings cases. *See, e.g., Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302 (2002); *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001); *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992).

Amici's members have a compelling interest in preserving their police power authority to adopt reasonable regulations and in ensuring that courts refrain from improperly second-guessing the wisdom of such legislative policy judgments. Reversal of the ruling below will eliminate the need for *amici*'s members to expend limited resources defending constitutional challenges rooted in an intrusive level of scrutiny for economic regulation unprecedented in modern times. Because of the importance of these issues to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of this case.

SUMMARY OF ARGUMENT

Amici agree with Petitioners Lingle and Bennett that the heightened means-end scrutiny applied by the court of appeals to invalidate Act 257 is not a proper test of regulatory

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[1] This brief was not authored in whole or in part by counsel for a party, and no person or entity other than *amici*, their members, and their counsel made a monetary contribution to the preparation or submission of this brief. The parties have consented to the filing of *amicus* briefs and have filed letters of blanket consent with the Clerk of the Court.

takings liability and that the correct standard for judicial review of economic legislation is the rational basis test under the Due Process Clause. *Amici* will not duplicate Petitioners' analysis in this brief, but instead offer two arguments that support reversal of the judgment below.

1. Adoption by this Court of the theory applied by the court of appeals—that heightened means-ends scrutiny is a proper test for regulatory takings liability—could inundate the federal courts with challenges to a wide range of state and municipal regulations. Although this case involves a rent control law, the court of appeals held without qualification that heightened scrutiny extends to all land use regulation subject to challenge under the Just Compensation Clause.

Moreover, the implications of the holding below extend well beyond land use regulation. There is no principled basis for limiting heightened means-ends scrutiny under the Just Compensation Clause to the regulation of real property. This Court's precedents include a number of cases in which economic regulations having nothing to do with land or land use have been challenged as regulatory takings. The Court has adjudicated takings claims asserted with respect to pension plan regulations, lawyers' trust accounts, coal industry health benefits, federal user fees, and laws regulating interest on interpleader funds. The lower federal courts have likewise entertained regulatory takings challenges to garden variety economic regulation.

Respondent argues that fears of the spread of heightened means-ends scrutiny are unfounded because the "substantially advance" formulation was articulated by this Court more than twenty years ago and no widespread upheaval has occurred in the federal courts. But this is because the lower federal courts generally have declined to apply this intrusive test. That would necessarily cease to be true if this Court affirms the judgment below and fails to make clear that rational basis review under the Due Process Clause is and long has been the

only appropriate test for judicial review of legislation such as Act 257.

Rational basis review has been applied by this Court to economic legislation for 70 years, and for reasons the Court has often stated. For example, in *United States v. Carolene Prods. Co.*, 304 U.S. 144 (1938), the Court rejected a due process challenge to a federal statute regulating milk shipments. It reasoned that "the existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless . . . it is of such a character as to preclude the assumption that it rests upon some rational basis." *Id.* at 152. In a subsequent case, the Court "emphatically refuse[d] to go back to the time when courts used the Due Process Clause 'to strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought.'" *Ferguson v. Skrupa*, 372 U.S. 726, 731-32 (1963) (citation omitted).

Under the heightened means-ends scrutiny applied by the court of appeals and urged upon this Court by Chevron, there would be no such deference to legislative judgments. Federal courts would be called upon to analyze complex economic and scientific data and to second-guess legislative policy judgments that underlie routine economic regulatory laws. Unless the judgment below is reversed, this Court could be compelled to reassess many of its regulatory takings rulings.

Supplanting rational basis review with heightened means-ends scrutiny would also alter the existing legal regime in several profound ways. Under rational basis review, a court may not invalidate a law on the grounds that the law might not succeed in achieving the legislature's goal. Nor is empirical evidence required to support a law challenged under this deferential standard. In addition, incremental legislative approaches to regulatory problems are clearly con-

stitutional under the rational basis test. Finally, the rational basis test does not require legislatures to articulate the reasons for enacting regulatory laws. All of these vital rules could change were this Court to affirm the application of heightened means-ends scrutiny to Act 257.

2. Reversal of the judgment below is also required because of the threat it poses to legislative authority, political accountability, and the effective working of our democratic institutions. Under our system of government, elected officials are responsible to the electorate and unpopular legislative choices can be remedied at the ballot box, thus ensuring the political accountability of elected officials. At the same time, deferential rational basis review is essential "'to preserve to the legislative branch its rightful independence and its ability to function.'" *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 365 (1973) (citation omitted).

Heightened means-ends scrutiny of state and local legislation by federal courts would unduly federalize classic local exercises of the police power in matters such as health and safety regulation, land use controls, and economic regulation. Such a sea-change would also carry the risk of judicial policymaking under the guise of takings analysis, with courts substituting their own policy preferences for those of legislatures. Finally, such unwarranted judicial invalidation of legislation would undermine the effectiveness of our democratically elected institutions by devaluing the entire legislative process.

ARGUMENT

The opening brief for Governor Lingle and Attorney General Bennett convincingly demonstrates that the heightened means-end scrutiny applied by the Ninth Circuit to invalidate Act 257 is not a proper test of regulatory takings liability under the Just Compensation Clause. Rather, review of economic legislation should be conducted under the Due

Process Clause using the rational basis standard. The text, structure, and history of the Just Compensation Clause are fundamentally inconsistent with the use of the Clause to invalidate legislation by applying heightened means-end scrutiny. The arguments presented by the Governor and Attorney General for reversing the Ninth Circuit's ruling need not be repeated here.

Instead, this amicus brief supplements Petitioners' submission in two ways. In section I, *amici* show that affirmance of the appeals court's ruling and endorsement by this Court of heightened means-end scrutiny as a test for regulatory takings liability could inundate the federal courts with hundreds of challenges to state and municipal regulations. Section II demonstrates that heightened means-end scrutiny of economic legislation under the Just Compensation Clause is flatly inconsistent with appropriate deference to politically accountable legislatures and the role of courts in our democracy.

I. ADOPTION OF HEIGHTENED MEANS-END SCRUTINY UNDER THE JUST COMPENSATION CLAUSE COULD RESULT IN HUNDREDS OF NEW CHALLENGES TO STATE AND MUNICIPAL REGULATIONS.

The lower court rulings are aberrational in the extreme, affording none of the requisite respect to the State of Hawaii's executive and legislative branches regarding the wisdom and efficacy of Act 257. The trial court abandoned any pretense of deference to the State's legislative judgment. After receiving testimony from competing experts at trial, the court concluded that Act 257 would not benefit Hawaii consumers because, in the court's view, the economic theories presented by Chevron's expert were "more persuasive" than the State's position. Pet. App. 43. Based on this finding, it held that the Act fails to substantially advance

a legitimate interest and thus violates the Just Compensation Clause. *Id.* at 50-53.

The court of appeals affirmed, applying heightened scrutiny under the Just Compensation Clause (*see id.* at 6-17, 58-66). It expressly rejected the rational basis test typically applied to economic legislation under the Due Process Clause (*see id.*), and gave no deference to the views of the state legislature regarding the wisdom and efficacy of Act 257. *See id.* at 17-21.

In short, the lower courts invalidated Act 257 because they disagreed with the judgment of the State's elected officials that the measure would protect the interests of Hawaii's consumers. The lower courts preferred Chevron's economic views and rejected the State's legislative judgment as to the efficacy of Act 257, much as the *Lochner* Court concluded that New York's worker protection laws were unwise. *See Lochner v. New York*, 198 U.S. 45 (1905).

A. The Ninth Circuit's Ruling Implicates Numerous Economic Regulations.

The ramifications of the Ninth Circuit's ruling are breathtaking, applying not only to all land use regulation, but to general economic regulation as well. Although this case involves rent control, the appeals court was clear in holding that heightened scrutiny extends to all land use regulation subject to challenge under the Just Compensation Clause. *See* Pet. App. 7 ("[The] more deferential, due process standard does not apply to regulatory takings claims challenging land use regulations."); *id.* at 15 (substantially advance test applies to all land use regulation). The primary case cited by both the Ninth Circuit and Chevron to justify the substantially advance formulation - *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980) - is not a rent control case, but instead a workaday zoning challenge that purports to articulate a general test for takings liability. Indeed, the court of appeals has applied

heightened scrutiny under the substantially advance formulation to other forms of land use controls.[2]

Application of heightened means-end scrutiny to all land use regulation would be disturbing enough. But the implications of Chevron's argument do not stop there. There is no principled basis for limiting heightened means-end scrutiny under the Just Compensation Clause to the regulation of real property. As this Court well knows, economic regulations having nothing to do with land also can be challenged as regulatory takings. The Court has entertained two regulatory takings challenges to pension plan regulations,[3] and it has considered other takings challenges to economic laws outside the context of land use controls.[4] The lower federal courts, too, have adjudicated many regulatory takings challenges to health and safety protections and other non-land use regulations.[5]

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[2] Pet. App. 12 (citing *Hotel & Motel Ass'n of Oakland v. City of Oakland*, 344 F.3d 959, 965 (9th Cir. 2003)).

[3] *See Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602, 641-47 (1993) (applying *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104 (1978), to reject an as-applied challenge to withdrawal liability provisions); *Connolly v. Pension Ben. Guar. Corp.*, 475 U.S. 211, 224-28 (1986) (applying the *Penn Central* factors to reject a facial takings challenge); *see also* pp. 12-14, *infra*.

[4] *E.g., Brown v. Legal Found. of Wash.* 538 U.S. 216, 240 (2003) (rejecting takings challenge to rules governing interest on lawyers' trust accounts); *Eastern Enters. v. Apfel*, 524 U.S. 498, 522-37 (1998) (plurality op.) (sustaining as-applied takings challenge to regulation of coal industry health benefits); *United States v. Sperry Corp.*, 493 U.S. 52, 59-64 (1989) (rejecting takings challenge to user fee for Iran-U.S. claims tribunal); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 160-65 (1980) (sustaining takings challenge to law regulating interest on interpleader funds).

[5] *E.g., Rose Acre Farms, Inc. v. United States*, 373 F.3d 1177, 1183-96 (Fed. Cir. 2004) (applying *Penn Central* in takings challenge to food

The appeal court's ruling is truly a radical outlier, flying in the face of decades of this Court's precedents holding that *Lochner*'s exacting means-end test for economic regulation has been supplanted by the deferential rational basis test. Under the appeals court's approach, many economic or social regulations could be challenged by an affected property owner in the hope that the court would second-guess the wisdom of the legislative policy choices, deem the law ineffective, and invalidate it under the Just Compensation Clause.[6]

Chevron suggests there is no need to fear heightened means-end scrutiny under the Just Compensation Clause because the Court articulated the "substantially advance" test more than twenty years ago in *Agins*, and yet the sky has not fallen. *See* Opp. 17-18. But the sky has not fallen because courts have rarely applied the test. *See, e.g., Bamber v. United States*, 45 Fed. Cl. 162, 165 (1999) (the *Agins* substantially advance formulation "has not had a fruitful life" outside of the narrow context of compelled dedications of land). As shown below at pp. 13-14, this Court has addressed several regulatory takings challenges without any reference to heightened means-end scrutiny. And the few lower courts that have applied the *Agins* test often use rational basis

safety regulations); *Coalition for Gov't Procurement v. Federal Prison Indus., Inc.*, 365 F.3d 435, 483-84 (6th Cir. 2004) (applying *Penn Central* to reject takings challenge by association of furniture manufacturers to increased furniture production by agency that manages federal inmate labor); *United States Fidelity & Guar. Co. v. McKeithen*, 226 F.3d 412, 416-20 (5th Cir. 2000) (applying *Penn Central* to sustain takings challenge to state law that altered funding formula for workers' compensation fund).

[6] *See* Vikram Amar, *Rent Control In Hawaii Goes All the Way to the Supreme Court* (Nov. 3, 2004) ("If the Supreme Court wants to affirm the Ninth Circuit in the Chevron case, it is going to have to explain why we all shouldn't fear *Lochner*'s rebirth."), *available at* http://writ.news.findlaw.com/amar/20041103.html.

review, not heightened scrutiny.[7] Particularly during the six years since the severe criticism of the test by five Justices in the concurring and dissenting opinions in *Eastern Enterprises*,[8] lower courts have been understandably gun-shy about applying heightened means-end scrutiny.

Chevron might attempt to cabin its position by arguing that a takings claimant must identify a cognizable property interest allegedly taken by the challenged regulation. But Chevron's asserted property interest in this case appears to be nothing more than the alleged "right" to charge unregulated rent. (Plainly, Hawaii has not taken the service stations themselves, and Chevron does not seek compensation for any such taking.) With so weak a constraint, any aggrieved property owner could recast an alleged injury as a "taking" of the right to use its property in the way the challenged law prohibits. In many cases, the claimant could easily articulate some stick in the bundle of property rights that the claimant alleges has been taken by an inconvenient law, and thereby insist upon heightened scrutiny.

Moreover, takings claimants invoking Chevron's proposed heightened scrutiny often would not be subject to the ordinary ripeness requirements that apply to other claimants under *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985). There would be no requirement to pursue administrative remedies to determine the extent to

[7] *See South County Sand & Gravel Co., Inc. v. Town of S. Kingstown*, 160 F.3d 834, 836 n.3 (1st Cir. 1998) (concluding that takings and due process means-end inquiries are "interchangeabl[e]"); *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993, 1004-07 (Cal. 1999) (declining to apply heightened scrutiny in affirming dismissal of takings challenge to city rent control law).

[8] *See* 524 U.S. at 539 (Kennedy, J., concurring in part and dissenting in part); *id.* at 550 (Stevens, J., joined by Souter, Ginsburg, and Breyer, JJ., dissenting); *id.* at 553 (Breyer, J., joined by Stevens, Souter, and Ginsburg, JJ., dissenting).

which the challenged regulation burdens the claimant's property because the substantially advance formulation often does not turn on the extent of that burden. Nor would it be necessary to seek compensation in state court as typically required under *Williamson County* because plaintiffs could seek invalidation, as Chevron does here. As a result, under Chevron's theory plaintiffs often would go directly to federal court, bypassing available administrative and state court remedies. And as shown below, plaintiffs could clog the already overburdened federal judiciary with challenges to laws that would otherwise easily survive rational basis review.

B. Heightened Means-End Scrutiny Could Muddy Decades of Settled Law and Call Into Question Many Existing Business Regulations.

If this Court were to adopt heightened means-end scrutiny under the Just Compensation Clause, seventy years of settled law analyzing regulation under the rational basis test could be put at risk. More to the point, numerous comparable present-day economic regulations would be up for grabs.

For example, in *United States v. Carolene Products Co.*, 304 U.S. 144 (1938), the Court rebuffed a due process challenge to a law prohibiting shipment of skimmed milk compounded with fat or oil other than milk fat. Congress enacted the measure because it found these substitutes caused undernourishment and disease, especially in children. *See id.* at 148-50 & n.2. The Court did not allow reargument of the public health issue, stressing that "the existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis." *Id.* at 152.

If, however, a business claimed that a newly enacted public health or safety measure banning a product worked a taking of its inventory, under heightened means-end scrutiny a judge would be forced to decide whether the ban substantially advances the public good, reweighing precisely the same evidence considered by the legislature. Many public health and safety laws could be subject to such judicial re-evaluation.

Similarly, in *Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483 (1955), the Court used the rational basis test to reject a due process challenge to a state law prohibiting an optician from fitting lenses without a prescription from an ophthalmologist or optometrist, even in the case of a broken lens. The district court invalidated the law as overbroad because an optician of ordinary skill could take a broken lens, measure its power, and reduce it to prescriptive terms. On appeal, this Court acknowledged that the law might be a "wasteful requirement in many cases." *Id.* at 487. It nevertheless ruled that "it is for the legislature, not the courts, to balance the advantages and disadvantages of the new requirement." *Id.* The Court speculated that "the legislature may have concluded that eye examinations were so critical . . . that every change in frames and every duplication of a lens should be accompanied by a prescription from a medical expert." *Id.* at 487. Under heightened scrutiny, however, plaintiffs could claim that many present-day business regulations work a taking by devaluing their businesses, and insist that courts reweigh the legislative judgment to determine whether the laws are so wasteful that they fail to substantially advance a legitimate interest.

Likewise, in *Ferguson v. Skrupa*, 372 U.S. 726 (1963), the Court rejected a due process challenge to a state law designed to reduce abuses against distressed debtors by prohibiting the business of debt adjustment except as an incident to the practice of law. The Court recognized that reasonable people

could disagree over whether the law advanced the public interest, stating that "[u]nquestionably, there are arguments showing that the business of debt adjusting has social utility." *Id.* at 731. But it stressed that any such arguments are for the legislature, "emphatically refus[ing] to go back to the time when courts used the Due Process Clause to 'strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought.'" *Id.* at 731-32 (quoting *Williamson*, 348 U.S. at 488).

Under heightened means-end scrutiny, however, there would be no such deference to the legislative judgment. Hundreds of business regulations could be challenged as a taking of the regulated property for failing to substantially advance a legitimate state interest. Federal judges would be called on to re-analyze complicated economic and scientific data and complex policy arguments to determine whether business regulations, health and safety laws, land use controls, and other federal, state, and local laws adequately advance the public interest. Regardless of the ultimate outcome on the merits, a burdensome trial frequently would be required because vexing factual issues would preclude dismissal or summary judgment.

C. Heightened Means-End Scrutiny Could Require this Court to Revisit Many Recently Decided Cases.

Recent constitutional challenges to federal economic regulation—such as the successive challenges to federal pension regulation in this Court—are also instructive. In 1984, the Court unanimously rejected a facial substantive due process challenge to withdrawal liability provisions in the federal statute governing multiemployer pension plans. *See Pension Ben. Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 728-34 (1984). The Court applied the deferential rational basis

standard for economic legislation set forth in *Skrupa* and *Williamson*, expressly declining to apply heightened scrutiny and concluding that the challenged provisions had a rational basis. *Id.* at 728-34.

Two years later, the Court unanimously rejected a facial challenge under the Just Compensation Clause to the same provisions. *See Connolly v. Pension Ben. Guar. Corp.*, 475 U.S. 211 (1986). In so ruling, it did not apply heightened means-end scrutiny, or any means-end scrutiny at all. Rather, it evaluated the provisions under the familiar multi-factor test set forth in *Penn Central*. *See Connolly*, 475 U.S. at 224-28. The *Connolly* Court made no mention of the "substantially advance" formulation for takings liability. Justice O'Connor, joined by Justice Powell, wrote separately to observe that the challenged provisions as applied in a specific case might "be so arbitrary and irrational as to violate the Due Process Clause," (*id.* at 228), but despite this means-end concern, they did not raise any comparable means-end issue under the Just Compensation Clause.

Then in 1993, the Court unanimously rejected as-applied challenges to the same statutory provisions under both the Due Process Clause and the Just Compensation Clause. *See Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602 (1993). The Court's substantive due process analysis proceeded under the deferential rational basis test (*id.* at 636-41), and the takings analysis proceeded under *Penn Central*'s multifactor test. *Id.* at 641-47. Again, there was no mention of the "substantially advance" formulation or any other heightened means-end scrutiny.

These rulings—and in particular the parallel due process and takings analyses in *Concrete* Pipe—show beyond reasonable dispute that the Just Compensation Clause does not generally require heightened means-end scrutiny of economic legislation. The sole exception concerns compelled dedi-

cations of land, a special category of land use controls governed by the "rough proportionality" test of *Dolan v. City of Tigard*, 512 U.S. 374, 391 (1994). As this Court recently reaffirmed, it has "not extended the rough-proportionality test of *Dolan* beyond the special context of exactions – land-use decisions conditioning approval of development on the dedication of property to public use" because the test is "not designed to address, and is not readily applicable to" other kinds of regulation. *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702-03 (1999).[9] If the Court were to adopt a general test of heightened means-end scrutiny in this case, it could be forced to revisit not only *Connolly* and *Concrete Pipe*, but many other unsuccessful constitutional challenges to federal, state, and local regulation.[10]

[9] *See also Dolan*, 512 U.S. at 391 (applying rough proportionality test to compelled dedication of land); *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 841 (1987) (applying logical nexus test to compelled dedication of land). Compelled dedications of land raise unique issues because, as explained in both *Dolan* and *Nollan*, they implicate the doctrine of unconstitutional conditions, which has little application to most other forms of regulation. *See Dolan*, 512 U.S. at 385 (discussing how compelled dedications of land trigger the doctrine of unconstitutional conditions); *Nollan*, 483 U.S. at 837 (comparing compelled dedications to unconstitutional conditions imposed on free speech rights).

[10] *See, e.g., United States v. Locke*, 471 U.S. 84, 105-06 (1985) (applying rational basis test to reject due process challenge to federal requirements resulting in the forfeiture of mining claims); *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 475-79 (1985) (applying rational basis test to reject due process challenge to requirement that private railroads reimburse Amtrak for rail travel privileges).

D. Heightened Means-End Scrutiny Could Subject Lower Federal Courts to Lengthy and Burdensome Trials to Resolve Complex Policy Disputes.

A recent example of means-end scrutiny gone awry at trial illustrates the dangers of heightened review of economic legislation. In *National Paint & Coatings Ass'n v. City of Chicago*, 45 F.3d 1124 (7th Cir. 1995), sellers of spray paint and indelible markers filed a substantive due process challenge to a 1992 Chicago graffiti ordinance that banned the sale of those items within city limits. The district court held a six-day trial, which included testimony from two respected economists who asserted that the ban effectively raised the price of spray paint in Chicago and thus reduced its use. Nevertheless, the district court found that the ban was ineffective because it did not deter vandals from producing graffiti. *Id.* at 1126-27. The court therefore concluded it violated the plaintiffs' substantive due process rights. *Id.*

On appeal, the Seventh Circuit had little patience with the trial court's aggressive means-end inquiry and reversed. Writing for a unanimous panel, Judge Easterbrook emphasized that "holding the trial in the first place usurped the legislative power" because "a legislative decision 'is not subject to courtroom factfinding and may be based on rational speculation unsupported by evidence or empirical data.'" *Id.* at 1127 (quoting *FCC v. Beach Communications, Inc.*, 508 U.S. 307 (1993)). Although the trial court might have correctly concluded that the cost of the ordinance outweighed the benefits, these matters were irrelevant because "the Constitution commits their decision to the political branches of government." *Id.*

In describing the appropriate level of scrutiny under rational basis review, the court stressed that "to say that such a dispute [of fact] exists—indeed, to say that one may be *imagined*—is to require a decision for the state." *Id.* The

Seventh Circuit concluded by expressing considerable skepticism over the wisdom of the ordinance, but it dismissed these concerns by quoting Justice Scalia's admonition that "'a law can be both economic folly and constitutional.'" *Id.* at 1132 (quoting *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 96-97 (1987) (Scalia, J., concurring)).

As *National Paint & Coatings* makes clear, heightened means-end scrutiny could result in a monumental waste of judicial resources. Cases addressing means-end challenges under the doctrine of substantive due process currently comprise only a tiny portion of the federal docket.[11] If this Court were to endorse heightened means-end scrutiny under the Just Compensation Clause, the number of means-end challenges could rise exponentially.

Indeed, supplanting rational basis review with heightened means-end scrutiny for economic regulation would alter the existing legal regime in several profound ways. First, under the rational basis test, a court may not invalidate a law simply because the law might not succeed in achieving the intended goal. *E.g.*, *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 464 (1981) (trial court's finding that ban on plastic milk

[11] Available statistics from the federal appellate courts are representative. In Fiscal Year 2003 (ending Sept. 30, 2003), there were 56,396 cases terminated by the federal appellate courts. *See* News Release, Administrative Office of the U.S. Courts, *Judicial Business of the Federal Courts in FY 2003*, at p. 5 (March 16, 2004), available at http://www.uscourts.gov/Press_Releases/judbus03.pdf. Of the roughly 25,000 reported and unreported appellate opinions issued during this period, only about 230 included the phrase "substantive due process." *Amici* arrived at this figure by conducting a search on the Westlaw electronic database according to the following parameters: "da(aft 09/30/2002 & bef 09/30/2003) & 'substantive due process'" in the "Courts of Appeals Cases—All Circuits after 1944" database, performed on Nov. 30, 2004. Presumably, of the 230 opinions that simply referred to substantive due process, an even smaller number resulted in a merits disposition of a substantive due process claim.

containers would not accomplish its goal of easing waste disposal did not compel invalidation because "States are not required to convince the courts of the correctness of their legislative judgments"). In contrast, the stated purpose of the "substantially advance" formulation is to find a taking of property where the challenged regulation does not adequately accomplish its goal. Under this approach, federal courts also would be forced to decide how long to wait before determining whether the challenged law has had an adequate opportunity to prove itself, an exceedingly indeterminate inquiry if ever there was one.

Second, under the rational basis test "a legislative choice is not subject to courtroom factfinding and may be based on rational speculation unsupported by evidence or empirical data." *Beach Communications*, 508 U.S. at 315; *accord Vance v. Bradley*, 440 U.S. 93, 110-11 (1979) (retirement age requirement not irrational despite absence of supporting empirical evidence). Under heightened means-end scrutiny, however, courtroom factfinding would be the order of the day, with armies of experts and reams of exhibits offered to show that the challenged regulation does or does not adequately advance the stated goals.

Third, to survive the rational basis test, a legislature need not "strike at all evils at the same time or in the same way." *Semler v. Oregon State Bd. of Dental Exam'rs*, 294 U.S. 608, 610 (1935). It "may implement [its] program step by step, . . . adopting regulations that only partially ameliorate a perceived evil and deferring complete elimination of the evil to future regulations." *City of New Orleans v. Dukes*, 427 U.S. 297, 303 (1976) (citations omitted); *accord Williamson*, 348 U.S. at 489. Under the heightened scrutiny of the "substantially advance" formulation, however, a takings plaintiff could argue that any portion of an incremental approach does not adequately advance the stated legislative goal.

Fourth, because legislation survives the rational basis test if there is any conceivable basis to support the regulation, the Court "never require[s] a legislature to articulate its reasons for enacting a statute," and thus "it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature." *Beach Communications*, 508 U.S. at 315. But under heightened scrutiny, the government would be required not only to articulate its reasons and goals, but also to show that the challenged law substantially advances those goals. Absent an express statement of legislative goals, courts would be called upon to delve into legislative motive, a notoriously hazardous inquiry courts are loath to undertake. *E.g.*, *Pacific Gas & Elec. Co. v. State Energy Res. Conserv. & Dev. Comm'n*, 461 U.S. 190, 216 (1983) ("[I]nquiry into legislative motive is often an unsatisfactory venture.").

The threat of numerous lawsuits seeking invalidation of statutes and regulations under the Just Compensation Clause would have a severe chilling effect on the ability of state and local officials to address a broad range of economic, social, and land use issues. *Amici* anticipate that plaintiffs would be creative in challenging community protections across the board. This potential chilling effect is not idle speculation but a hard reality for state and local officials.[12]

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[12] *See, e.g., Hearing on H.R. 2372 Before the Subcomm. on the Constitution of the House Comm. on the Judiciary*, 106th Cong. (1999) (Statement of Diane S. Shea, Associate Legislative Director, National Association of Counties) (*available at* http://www.house.gov/judiciary/shea0915.htm) (discussing the chilling effect that the threat of takings litigation has on small municipalities at the expense of neighboring property owners and the public interest). This testimony persuasively shows that expansive takings theories can have a severe chilling effect even where those theories are limited to land use regulation. Of course, if Chevron prevails here, heightened scrutiny would have a chilling effect not only on land use controls, but on economic regulation generally.

II. ADOPTION OF HEIGHTENED MEANS-END SCRUTINY OF ECONOMIC REGULATION WOULD UNDERMINE LEGISLATIVE AUTHORITY AND POLITICAL ACCOUNTABILITY.

Continued rejection of *Lochner*-esque scrutiny for economic regulation is critical to the structure of our constitutional democracy for several reasons. First, as this Court has noted repeatedly, the "formulation, execution, or review of broad public policy . . . go to the heart of representative government." *Sugarman v. Dougall*, 413 U.S. 634, 647 (1973) (quoted in *Gregory v. Ashcroft*, 501 U.S. 452, 462 (1991)). Elected officials make policy decisions with the interests of the citizens in mind and with full knowledge that unpopular choices can be remedied at the ballot box. As early as *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824), this Court recognized that legislative action is primarily constrained not by the courts, but by "[t]he wisdom and the discretion of Congress, their identity with the people, and the influence which their constituents possess at elections." *Id.* at 197.

Rational basis review of economic legislation is essential to legislative authority and independence. "'Only by faithful adherence to this guiding principle of judicial review of legislation is it possible to preserve to the legislative branch its rightful independence and its ability to function.'" *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356, 365 (1973) (quoting *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 510 (1937)). When courts override legislative choices, they insulate elected officials from accountability, removing issues from the public arena that would otherwise be sorted out through the electoral process. "[F]ederal judges—who have no constituency—have a duty to respect legitimate policy choices made by those who do." *Chevron, U.S.A., Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 866 (1984).

The *Lochner* era is rightly criticized by scholars across the jurisprudential spectrum for its failure to respect the will of legislative majorities. *Compare* Robert H. Bork, *The Tempting of America: The Political Seduction of the Law* 48-49 (1990) (criticizing *Lochner* era cases for overriding legislative majorities) *with* Cass R. Sunstein, *Lochner's Legacy*, 87 Colum. L. Rev. 873, 874 (1987) (same). And every Member of the Court has joined opinions criticizing the more searching scrutiny of economic regulation that characterized the *Lochner* era.[13]

These political process objections are especially weighty where, as here, there is no textual basis in the Constitution for greater judicial intrusion. As Justice Holmes observed, "the proper course is to recognize that a state legislature can do whatever it sees fit to do unless it is restrained by some express prohibition in the Constitution of the United States or of the State, and that Courts should be careful not to extend such prohibitions beyond their obvious meaning by reading into them conceptions of public policy that the particular Court may happen to entertain." *Tyson & Brother v. Banton*, 273 U.S. 418, 446 (1927) (Holmes, J., joined by Brandeis, J., dissenting).

Second, heightened means-end scrutiny under the Just Compensation Clause by federal courts would inappropriately federalize health and safety regulation, land use controls, and other economic regulation. Appropriate deference ensures that States and municipalities have the flexibility they need to be creative in addressing local issues and tailoring solutions

[13] *See, e.g., College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 690 (1999) (Scalia, J., joined by Rehnquist, C.J., and O'Connor, Kennedy, and Thomas, JJ.) (referring to "the discredited substantive-due-process case of *Lochner*"); *id.* at 701 (Breyer, J., joined by Stevens, Souter, and Ginsburg, JJ., dissenting) (describing *Lochner* as improperly limiting legislative flexibility without constitutional warrant).

to fit local conditions. By aggrandizing authority to federal courts, heightened scrutiny of economic regulation would impair the critical role of a State or local government to "serve as a laboratory[] and try novel social and economic experiments without risk to the rest of the country." *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

Third, courts are ill-equipped to decide complex matters of economic policy. Legislatures have the resources and time to engage in complex fact-finding and analysis, which "are not wisely required of courts." *Pegram v. Hedrich*, 530 U.S. 211, 221 (2000); *Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 665-66 (1994) (plurality op.) ("Congress is far better equipped than the judiciary to amass and evaluate the vast amounts of data bearing upon an issue as complex and dynamic as that presented here." (internal citations and quotations omitted)). This is especially true where the benefits of a given policy choice are controversial and the data supporting that choice are subject to different interpretations. As the Court made clear in *Patsy v. Board of Regents*, 457 U.S. 496 (1982), "[t]he very difficulty of these policy considerations, and Congress' superior institutional competence to pursue this debate, suggest that legislative not judicial solutions are preferable." *Id.* at 513.

Fourth, because courts lack institutional competence to address complex policy matters, heightened scrutiny of economic regulation raises a serious risk of judicial policy-making under the guise of takings analysis, with judges advancing personal predilections at the expense of legislative judgment. The Court has emphasized that rational basis review of economic regulation is "a paradigm of judicial restraint" because "[w]here there are 'plausible reasons' for Congress' action, 'our inquiry is at an end.'" *Beach Communications*, 508 U.S. at 313-14 (quoting *United States R.R. Ret. Bd. v. Fritz*, 449 U.S. 166, 179 (1980)). As shown

in Section I above, a searching means-end inquiry into economic regulation is so open-ended that a judge's personal philosophy could tip the scales in any given case.

Fifth, undue judicial invalidation of legislative judgment undermines civic education and the participation of the citizenry in our democracy. In his classic work *The Least Dangerous Branch*, Professor Alexander Bickel reiterated James Bradley Thayer's concern that undue judicial intrusion corrodes the moral education of the people:

> "[T]he exercise of it [the power of judicial review], even when unavoidable, is always attended with a serious evil, namely, that the correction of legislative mistakes comes from the outside, and the people thus lose the political experience, and the moral education and stimulus that comes from fighting the question out in the ordinary way, and correcting their own errors. The tendency of a common and easy resort to this great function, now lamentably too common, is to dwarf the political capacity of the people, and to deaden its sense of moral responsibility."

Alexander M. Bickel, *The Least Dangerous Branch* 22 (1986) (citation omitted).

Judge Learned Hand articulated the same concern when he expressed fear that judicial Platonic Guardians would destroy the civic stimulus upon which our democracy rests: "For myself it would be most irksome to be ruled by a bevy of Platonic Guardians, even if I knew how to choose them, which I assuredly do not. If they were in charge, I should miss the stimulus of living in a society where I have, at least theoretically, some part in the direction of public affairs." Learned Hand, *The Bill of Rights* 73 (1960).

In short, this Court should reject heightened scrutiny of economic regulation under the Just Compensation Clause for the same reasons it abandoned the heightened review of the

Lochner Era. Because the ruling below threatens a retreat to *Lochner*, it should be overturned.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and MARK J. BENNETT, Attorney General of the State of Hawaii,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE STATES OF NEW YORK, CALIFORNIA, ALASKA, ARIZONA, COLORADO, CONNECTICUT, DELAWARE, IDAHO, ILLINOIS, IOWA, KENTUCKY, MAINE, MARYLAND, MASSACHUSETTS, MINNESOTA, MISSISSIPPI, MONTANA, NEW JERSEY, OKLAHOMA, OREGON, PENNSYLVANIA, RHODE ISLAND, TENNESSEE, UTAH, VERMONT, WASHINGTON, AND WEST VIRGINIA, THE COMMONWEALTHS OF PUERTO RICO AND THE NORTHERN MARIANA ISLANDS, AND THE TERRITORIES OF AMERICAN SAMOA, GUAM, AND THE VIRGIN ISLANDS, AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo*, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

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INTEREST OF THE *AMICI CURIAE*

Amici States, Commonwealths, and Territories, through their legislative and executive branches, routinely engage in many forms of regulation that affect economic interests. The challenges posed by new patterns of growth and development, a rapidly-changing economy, advances in science and technology, and increased understanding of public health risks and environmental harms require the states to respond and, on occasion, to experiment with regulations that seek to address these challenges. Accordingly, the *amici* have an interest how regulatory takings jurisprudence affects their ability to implement regulatory programs to protect the health and welfare of their citizens. For at least 70 years, the legislatures and regulatory agencies of the *amici* States have had considerable discretion within the federal system to fashion responses to various problems, *see generally Ferguson v. Skrupa*, 372 U.S. 726, 731 (1963); *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937). *Amici* have a keen interest in maintaining the deference that courts have traditionally given the States in making the countless policy choices of how to meet the economic, social, and health needs of their citizens.

The Ninth Circuit's decision threatens to complicate, perhaps even paralyze, these routine exercises of the States' police power. The ruling encourages challenges under the Just Compensation Clause that are premised on the so-called "means-ends" test mentioned in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980). *Agins* suggests that land-use regulation "effects a taking if [it] does not substantially advance legitimate state interests." *Id.* Since announcing that test, the Court has never used the *Agins* standard to strike down a generally-applicable statute or regulation as a regulatory

taking violative of the Just Compensation Clause. As this Court has recently indicated, despite *Agins* it is far from clear whether generally-applicable legislation should even be subject to a means-ends test in order to determine whether a taking has occurred.

The Ninth Circuit, however, not only employed such a test but made it an exceedingly stringent one. Its decision requires a court to enjoin the operation of economic legislation under the Just Compensation Clause if the court, after conducting a *de novo* review of the statute, concludes that the challenged law will not in fact accomplish the legislature's intended goal.

In doing so, the lower court upset the careful balance of power that our federal system strikes between democratically-elected state and local regulatory bodies on the one hand and the judiciary on the other. If allowed to stand, the Ninth Circuit's decision will severely constrain the options for a legislature grappling with urgent and competing policy concerns. Courts will have to scrutinize not the rationality of a regulation, but whether the legislative "means" chosen by the elected members of state government will, in the court's own view and as a matter of fact, achieve their "ends." The Ninth Circuit's decision threatens to establish the federal courts as overseers of state laws, routinely inquiring whether the state has made the "correct" policy choice to respond to a particular problem. This scheme would represent a sharp departure from the distribution of authority in our federal system.

SUMMARY OF THE ARGUMENT

The *Agins* "substantially advance" test conflicts with the language and structure of the Just Compensation Clause. That provision is not a substantive limitation on governmental process. Rather, by its terms the Just Compensation Clause presupposes the legitimacy of government action and requires only that the government provide compensation when it takes private property.

The *Agins* test instead needlessly duplicates the means-ends scrutiny of government action that the substantive component of the Due Process Clause requires. Indeed, *Agins* itself derives entirely from a line of due process and equal protection decisions.

A majority of this Court has already recognized the incongruity of lodging a "substantially advance" test within regulatory takings jurisprudence. Nor does this Court's adoption of a means-ends test to measure the validity of exactions vitiate this recognition. As the Court has noted, such a test is peculiarly appropriate to evaluating the validity of exactions, which are individualized land-use decisions conditioning approval of development on the dedication of property to public use. It has no application to government regulation outside that context.

Even if a "substantially advance" test is appropriate for challenges to regulatory takings under the Just Compensation Clause, it requires only deferential rational-basis review. Post-*Agins* decisions regularly apply such a standard when reviewing generally-applicable statutes and regulations that affect property interests. This deferential standard is necessary to prevent courts from sitting as superlegislatures

and second-guessing the wisdom of the elected branches of government. Any stricter scrutiny – much less the decisive factual demonstration of a statute's effectiveness required by the courts below – will inhibit the states from developing and experimenting with policies that address evolving problems.

I. The Just Compensation Clause Does Not Require That Generally-Applicable Legislation "Substantially Advance" A Legitimate Government Interest

A. The "Substantially Advance" Test Does Not Belong in Regulatory Takings Jurisprudence Because the Just Compensation Clause Presupposes the Legitimacy of Governmental Action

The *Agins* "substantially advance" test conflicts with the key assumption underlying the Just Compensation Clause. While the *Agins* test focuses on the potential illegitimacy of governmental activity, the Just Compensation Clause presupposes the legitimacy of the government action and operates simply as a conditional limitation, permitting the government to take private property as long as it provides compensation.[1] *First English Evangelical Lutheran Church of*

1. The Just Compensation Clause provides "nor shall private property be taken for public use without just compensation." The *Agins* "substantially advance" test asks whether a governmental action effects a "taking" by focusing on the extent to which a regulation fulfills a concededly-valid public purpose. This is distinct from the threshold inquiry under the "public use" component of the Just Compensation Clause, which asks whether a governmental action alleged to be a "taking" has a "public purpose" at all. *See, e.g., Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 240-43 (1984); *National Railroad Passenger Corp. v. Boston and Maine Corp.*, 503 U.S. 407, 422 (1992). Neither the nature of this threshold inquiry nor its outcome is at issue in the present case.

Glendale v. County of Los Angeles, 482 U.S. 304, 314-15 (1987). Stated differently, the Just Compensation Clause seeks to ensure compensation for a taking of private property, not to prevent government from adopting irrational regulatory schemes. It is not a substantive limitation on governmental power. Just as a government's physical takings of private property require that it pay the owner just compensation, regulatory takings jurisprudence analyzes whether a regulation imposes restrictions so severe that it is tantamount to a condemnation or an appropriation. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 414-15 (1922) (finding a regulatory taking because a statute that "[made] it commercially impracticable to mine certain coal [had] very nearly the same effect for constitutional purposes as appropriating or destroying it"). While a generally-applicable regulation that is not rationally related to some legitimate governmental interest may violate the Due Process Clause, such irrationality is not the equivalent of a condemnation or appropriation. It therefore does not violate the Just Compensation Clause.

The incongruity of lodging a "substantially advance" test within regulatory takings jurisprudence is confirmed by *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), where five justices rejected a Just Compensation Clause challenge to the federal Coal Industry Retiree Health Benefit Act ("Coal Act"). Justice Kennedy opined that "the takings analysis is inapplicable" to challenges to the substantive validity of government regulation. 524 U.S. at 547. Four other Justices agreed that "the Constitution's Takings Clause does not apply to such challenges." *Id.* at 554.

Citing *Agins*, Justice Kennedy recognized that the means-ends standard "open[s] the door to normative considerations

about the wisdom of government decisions" and that "[t]his sort of analysis is in uneasy tension with our basic understanding of the Takings Clause, which has not been understood to be a substantive or absolute limit on the Governments's power to act." 524 U.S. at 545 (Kennedy, J., concurring in the judgment and dissenting in part). This "uneasy tension" results from the fact the Just Compensation Clause "presupposes what the government intends to do is otherwise constitutional." *Id.* (citing *First English*, 482 U.S. at 314-15); *accord Mahon*, 260 U.S. at 415. Since "the constitutionality of the Coal Act appear[ed] to turn on the *legitimacy of Congress' judgment* rather than on the availability of compensation," Justice Kennedy opined that "the more appropriate constitutional analysis arises under general due process principles rather than under the Takings Clause," 524 U.S. at 545 (emphasis added), and that "we should proceed first to general due process principles, reserving takings analysis for cases where the governmental action is otherwise permissible." *Id.* at 546. Similarly, Justice Breyer, speaking for the four dissenters, stated that "at the heart of the [Just Compensation] Clause lies the concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for *legitimate* government action that takes 'private property' to serve the 'public' good." 524 U.S. at 554 (first emphasis in original, second emphasis added).

The Court's subsequent decision in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), did not vitiate this aspect of *Eastern Enterprises*. In *Del Monte Dunes* the Court upheld a district court's finding that a series of adverse zoning determinations by the City of Monterey constituted a taking. The finding was based on jury instructions (to which the defendant city had waived any

objection) incorporating the "substantially advance" principle. But five of the Justices either wrote or joined opinions reserving the question of the validity of the substantially-advance test. *See Del Monte Dunes*, 526 U.S. at 732 n.2 (Scalia, J. concurring) (the City "forfeited any objection to this standard . . . , and I express no view as to its propriety"); *id.* at 753-54 n.12, n.13 (Souter, J. dissenting, joined by O'Connor, Breyer, Ginsburg, JJ.) (offering "no opinion here on whether *Agins* was correct in assuming that this prong of liability was property cognizable as flowing from the Just Compensation Clause of the Fifth Amendment as distinct from the Due Process Clauses of the Fifth and Fourteenth Amendments"). Furthermore, the majority opinion acknowledged that the Court had never explained the "nature or applicability" of the "substantially advance" standard outside the physical exaction context and declined to explain it, given that Monterey waived any objection to the jury instructions. 526 U.S. at 704.

Thus, a majority of the Court has recognized that the *Agins* "substantially advance" formulation is at odds with the Just Compensation Clause. Accordingly, that standard should not be incorporated in regulatory takings jurisprudence, but rather should remain a part of due process analysis, under which state statutes that lack a rational basis may be invalidated.

B. Means-Ends Scrutiny of the Validity of Legislation and Regulatory Decisions Under the Takings Clause is Unnecessary Because Such Review is Already Required By the Due Process Clause

There is no need to import the *Agins* "substantially advance" standard into regulatory takings jurisprudence because the Due Process Clause provides an independent check on irrational enactments that serve no government interest. Under the due process standard, courts may inquire whether "it might be thought that the particular legislative measure was a rational way to correct [a particular problem]." *Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 487-88 (1955); *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 124-25 (1978).

Courts have invalidated statutes and regulatory actions under a rationality standard in the context of due process challenges. *See, e.g., Nectow v. City of Cambridge*, 277 U.S. 183 (1928) (portion of city zoning ordinance invalidated under the Due Process Clause).[2] Indeed, this Court itself has

2. *See also Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334, 343 & n.1 (N.J. 2001), *cert. denied*, 535 U.S. 1077 (2002); *San Carlos Apache Tribe v. Superior Court*, 972 P.2d 179, 189 (Ariz. 1999) (State statute violates substantive due process protection of Arizona's constitution because it retroactively alters vested property rights in water); *Pitocco v. Harrington*, 707 A.2d 692, 696 (R.I. 1998) (reversing dismissal of substantive due process claim because, if proven, government official's denial of a building permit for reasons other than those authorized in the applicable ordinance would be arbitrary); *L.A. Ray Realty v. Town Council of Cumberland*, 698 A.2d 202 (R.I. 1997) (Town officials violated substantive due process rights of developers where they denied the developers' subdivision applications without any legal basis and with animus); *Town of* (Cont'd)

indicated that a due process standard is appropriate for evaluating the validity of most generally-applicable zoning regulations. *Dolan v. City of Tigard*, 512 U.S. 374, 391 n.8 (1994) ("in evaluating most generally applicable zoning regulations, the burden rests on party challenging the regulation to prove that it constitutes an arbitrary regulation of property rights"). There is no need to distort regulatory takings law to fit Chevron's claim, since the "substantially advance" inquiry already has a natural home in due process jurisprudence.

C. The *Agins* "Substantially Advance" Formulation Has No Basis in the Just Compensation Clause, But Simply Reflects Long-Standing Due Process and Equal Protection Principles

The Court's apparent discomfort with the *Agins* test may reflect its recognition that the test has no basis in Takings Clause jurisprudence. A review of *Agins's* supporting citations confirms that its "substantially advance" test reflects nothing more than the traditional standard of review based on the Due Process and Equal Protection Clauses, as opposed to the Just Compensation Clause. The formulation is rooted exclusively in a series of zoning cases decided in the late

(Cont'd)

Orangetown v. Magee, 665 N.E.2d 1061 (N.Y. 1996) (landowners who were denied substantive due process because the town decision affecting their property had been made in an arbitrary and capricious manner and without any rational basis recovered five million dollar verdict); *Tampa-Hillsborough County Expressway Authority v. A.G.W.S. Corp.*, 640 So. 2d 54, 57 (Fla. 1994); *Lutheran Day Care v. Snohomish County*, 829 P.2d 746, 748, 763 (Wash. 1992) (County violated substantive due process because it acted arbitrarily and capriciously in denying a conditional use permit to build a rest home), *cert. denied*, 506 U.S. 1079 (1993).

1920's, culminating in *Nectow v. City of Cambridge*, 277 U.S. 183 (1928). Each of the cases concerned the Due Process or Equal Protection Clauses; each requested equitable relief; each employed the same deferential standard of review; and none invoked the Just Compensation Clause or requested compensation.

The first, *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926), concerned a due process and equal protection claim seeking to enjoin a municipal zoning ordinance. The Court squarely rejected the due process and equal protection challenges, using the deferential standard of review appropriate for such challenges:

> [the statute's] reasons are sufficiently cogent to preclude us from saying, as it must be said before an ordinance can be declared unconstitutional, that such provisions are clearly *arbitrary* and *unreasonable*, having *no substantial relation* to the public health, safety, morals, or general welfare.

272 U.S. at 395 (emphasis added).

That term saw the Court employ the same standard to sustain two other zoning ordinances. *Zahn v. Board of Public Works for the City of Los Angeles*, 274 U.S. 325, 327 (1927), relying on *Euclid* and other cases, upheld a statute designating various zoning districts against a due process and equal protection challenge. A few days later, *Gorieb v. Fox*, 274 U.S. 603 (1927), rejected a due process and equal protection challenge to a zoning ordinance that imposed a building set-back requirement. Employing the same language and standard used in *Euclid* and *Zahn*, the Court sustained the ordinance

because it was not "clearly arbitrary and unreasonable, having no substantial relation to the public health safety morals or general welfare." 274 U.S. at 610.

The next year in *Nectow*, the Court applied the same standard in reviewing an "as-applied" challenge to a general zoning ordinance. 277 U.S. 183. The complaint alleged that the ordinance, as applied to the landowner, "deprived him of his property without due process of law in contravention of the Fourteenth Amendment." *Id.* at 185-86. Using the same "substantial relation" language employed in *Euclid* and *Zahn*, the Court reaffirmed those holdings and the general validity of zoning ordinances:

> a court should not set aside the determination of public officers in such a matter unless it is clear that their action "has no foundation in reason and is a mere *arbitrary* or *irrational* exercise of power having *no substantial relation* to the public health, the public morals, the public safety or the public welfare in its proper sense."

277 U.S. at 188 (quoting *Euclid*, 272 U.S. at 395) (emphasis added). On the basis of factual findings made by a special master appointed by the trial court, the Court determined that the particular application of the zoning ordinance to plaintiff's property did not promote the health and safety of the local inhabitants. 277 U.S. at 188-89. For this reason, the ordinance as approved did "not bear a substantial relation to the public health, safety, morals, or general welfare," and the Court sustained the plaintiff's due process claim. 277 U.S. at 188.

Euclid, *Zahn*, *Gorieb*, and *Nectow* all applied the same deferential standard to review property owners' various due process and equal protection claims. Fifty years later in *Agins*, the Court restated the *Nectow* test, apparently transplanting it to the inhospitable soil of the Just Compensation Clause without acknowledging it was doing so: "The application of a general zoning law to particular property effects a taking if the ordinance does not substantially advance legitimate state interests, *see Nectow v. Cambridge*, 277 U.S. 183, 188 (1928) . . ." *Agins*, 447 U.S. at 260.[3] *Agins* thus cannot and should not be understood to establish a new standard based on the Just Compensation Clause to evaluate takings challenges to generally- applicable regulations.

While the Court has referred to the *Agins* formulation on several occasions, *see Del Monte Dunes*, 526 U.S. at 704 (1999) (citing cases), it has never used that standard to strike down a generally-applicable regulation as a regulatory taking violative of the Just Compensation Clause. To the contrary, in *Dolan*, the Court, relying on *Euclid* rather than *Agins*, agreed that "in evaluating most generally applicable zoning regulations, the burden properly rests on the party challenging

3. While *Agins* is commonly understood as the source of the "substantially advance" standard, the Court noted, in *dictum*, a related concept two years before in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978). There, the Court mentioned that "a use restriction may constitute a taking if not reasonably necessary to the effectuation of a substantial governmental purpose." *Id.* at 127. In support of this observation, the Court cited *Nectow* and *Goldblatt v. Town of Hempstead*, 369 U.S. 590 (1962). As previously discussed, *Nectow* is a due process case. So, too, is the relevant portion of *Goldblatt*: *Penn Central's* reference to a "reasonably necessary" standard is rooted in *Goldblatt's* discussion of due process principles. *See* 369 U.S. at 594-95 (citing *Lawton v. Steele*, 152 U.S. 133, 137 (1894)).

the regulation to prove that it constitutes an arbitrary regulation of property." *Dolan*, 512 U.S. at 391 n.8 (citing *Euclid*). As the roots of the *Agins* test in *Euclid* and *Nectow* reveal, the Court's reliance on *Euclid* in *Dolan* suggests, and many lower courts agree,[4] challenges based on the asserted arbitrariness of generally-applicable regulations should be brought under the Due Process Clause, not the Just Compensation Clause.

The *Nollan* and *Dolan* exaction decisions do not help Chevron. *See Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987); *Dolan v. City of Tigard*, 512 U.S. 374 (1994). Individualized exactions – land-use decisions conditioning approval of development on the dedication of property to public use – represent a special category of claim under the Just Compensation Clause. Even if means-ends scrutiny of government decisions were unavailable under *any* constitutional provision, the Court might well want to use it for exactions, for which it is uniquely appropriate.

4. *See, e.g.*, *Rith Energy, Inc. v. United States*, 270 F.3d 1347, 1352 (Fed. Cir. 2001) (refusing to consider the appellant's claim that the government's revocation of a coal-mining permit which was allegedly "driven by political pressure" constituted a taking); *Simi Investment Co. v. Harris County*, 256 F.3d 323 n.3 (5th Cir.) (on petition for rehearing *en banc*) (citing *Eastern Enterprises* and noting that challenges alleging that government interference with property interests is impermissibly "illegitimate and arbitrary" arise under the Due Process Clause, not the Takings Clause), *cert. denied*, 534 U.S. 1022 (2001); *Restigouche, Inc. v. Town of Jupiter*, 59 F.3d 1208, 1211 n.1 (11th Cir. 1995) ("We do not recognize ["substantially advance" takings claims] as distinct, viable federal constitutional claims in the zoning context."); *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334, 343 n.1 (N.J. 2001), *cert. denied*, 535 U.S. 1077 (2002); *Mission Springs, Inc. v. City of Spokane*, 954 P.2d 250, 261 (Wash. 1998); *Brunelle v. Town of South Kingstown*, 700 A.2d 1075, 1083 n.5 (R.I. 1997); *Tampa-Hillsborough County Expressway Authority v. A.G.W.S. Corp.*, 640 So.2d 54, 57 (Fla. 1994).

This appropriateness derives from the fact that, as this Court has recognized, exactions are regulatory takings in form but physical takings in substance. *See Nollan*, 483 U.S. at 831-32. Whereas a government is per se liable to property owners for all its physical takings, it need pay just compensation for only certain regulatory actions. *See, e.g., Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978). Thus, there is a risk that a government will attempt to leverage an uncompensated physical taking out of the happenstance of a permit application. On the other hand, treating all individualized exactions as physical takings and requiring payment of just compensation for them hampers government in its ability to facilitate development of property while responding to such development with appropriate conditions that mitigate its effects. *See, e.g., Nollan*, 483 U.S. at 836 ("a permit condition that serves the same legitimate police-power purpose as a refusal to issue the permit" is not a taking "if the refusal to issue the permit would not constitute a taking").

The solution, as *Nollan* and *Dolan* make clear, is "some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Dolan*, 512 U.S. at 391. A nexus requirement between the condition imposed by an exaction and "the public need or burden [the proposed development] creates or to which it contributes," *Nollan*, 483 U.S. at 838, guarantees that the exaction is responsive rather than opportunistic. Thus, for example, in *Nollan*, an exaction that required physical access across the applicant's property as a condition of a proposed development that would have hindered only the public's "visual access" lacked a nexus with the burden imposed by the development, whereas "a condition that would have protected the public's ability

to see the beach notwithstanding construction" could have been constitutional. *Id.* at 836. Similarly in *Dolan*, the development that affected a flood plain would have justified a permit condition requiring a private buffer area designed to mitigate flooding, but not a permit condition requiring public access to the buffer area. 512 U.S. at 392-93. The exaction, as the Court saw it, lacked "rough proportionality" to the development to which it purported to respond. *Id.* at 391. But as the Court has recognized, *Nollan-Dolan* means-ends scrutiny does not apply "beyond the special context of exactions." *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702 (1999).[5] Proportionality review under the Takings Clause is designed to detect physical takings disguised as regulatory adjudications. It is uniquely suited to that purpose. It has no relevance to "essentially legislative determinations," *Dolan*, 512 U.S. at 384-85; *see also Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 323 (2002) (it is "inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim that there has been a 'regulatory taking,' and vice versa").

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5. Although *Yee v. City of Escondido*, 503 U.S. 519, 530 (1992), contains *dictum* implying that *Nollan's* nexus analysis might apply to rent control cases, *Yee* predates the clarification in *Del Monte Dunes* that the *Nollan/Dolan* standard is confined to exactions.

II. Even If Regulatory Takings Claims Authorize Judicial Review Of The Reasonableness Of Generally-Applicable Legislation, Such Review Must Be Deferential

Even if the Court decides to approve the use of the "substantially advance" test in regulatory takings challenges, it should make clear that the test requires only the deferential "rational basis" review applied in substantive due process challenges, not the Ninth Circuit's highly-intrusive de novo standard. As discussed above, the *Agins* test derived from *Nectow*, which (along with its antecedent, *Euclid*) employed a deferential standard of review. Because *Agins* apparently meant to apply the *Euclid-Nectow* standard, albeit in the new setting of the Just Compensation Clause, the *Agins* standard cannot be any more rigorous than the deferential substantive due process standard of *Euclid* and *Nectow*. Under this standard, only a statute that is "arbitrary" and "unreasonable" would have "no substantial relation" to the public welfare.

Schad v. Borough of Mount Ephraim, 452 U.S. 61 (1981), decided one year after *Agins*, confirms this understanding that the *Agins* standard is deferential. In *Schad*, the Court emphasized that *Agins*, *Euclid*, and *Nectow* applied the identical, highly deferential "rationally related" standard:

> Where property interests are adversely affected by zoning, the courts generally have emphasized the breadth of municipal power to control land use and have sustained the regulation if it is rationally related to legitimate state concerns and does not deprive the owner of economically viable use of his property. [*citing, inter alia Agins and*

> *Euclid*] But an ordinance may fail even under that limited standard of review. [*citing, inter alia, Nectow*]

452 U.S. at 68.

Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), which has several similarities to this case, employs the same approach. *Exxon* involved a due process challenge to a Maryland gasoline-station statute that was more intrusive than Hawaii's. Rather than merely restricting the rents that oil companies could charge lessee gas stations, Maryland's statute flatly prohibited oil companies from owning retail gas stations. The prohibition was based on a concern that, during oil shortages, oil companies would favor their own stations over independent dealers and thus harm consumers. *Id.* at 121. Just as Chevron here presented the testimony of an economist, Exxon presented the testimony of four economists that the Maryland statute would reduce competition and therefore hurt consumers. *Governor of Maryland v. Exxon Corp.*, 370 A.2d 1102, 1108 (Md. 1977). In response, this Court deferred to the judgment of the state legislature. It unanimously held that it was not the judiciary's role to evaluate "the economic wisdom of the statute." *Exxon*, 437 U.S. at 124-25. The Court determined that as long as the State had a legitimate purpose, the "ultimate economic efficacy of the statute" was irrelevant; it was enough that the State's purpose in enacting the statute, namely "controlling the gasoline retail market," was legitimate. 437 U.S. at 124-25. "Regardless of the ultimate economic efficacy of the statute," the Court had "no hesitancy in concluding that it bears a reasonable relation to the State's legitimate purpose in controlling the gasoline retail market, and we therefore reject appellants' due process claim." *Id.*

The Ninth Circuit showed none of the deference *Exxon* requires. While never questioning the legitimacy of the State's purpose in enacting its statute, it directed the district court to engage in predictive fact finding, 224 F.3d at 1039, and then to determine whether Act 257 "will in fact lead to lower fuel prices." *Id.* at 1041. The district court accordingly analyzed "the efficacy of maintaining independent lessee-dealers in the context of Hawaii's purpose for enacting the Act," and found, after hearing and weighing the conflicting evidence presented at trial, that the challenged statute would not in fact achieve the goal of lower retail gas prices. 363 F.3d at 856. The Ninth Circuit, upholding the district court's conclusion, believed that the Just Compensation Clause mandates such a microscopic inquiry into the accuracy of a legislature's judgments about the efficacy of the policies it chooses. Nothing this Court has ever said justifies such intense scrutiny of state regulation under the Just Compensation Clause. To the extent it has applied a means-ends test in reviewing regulatory takings challenges, this Court has used an extremely deferential standard, akin to the "rational relationship" test under the substantive component of the Due Process Clause.

Keystone Bituminous Coal Ass'n. v. DeBenedictis, 480 U.S. 470 (1987), establishes that the Just Compensation Clause, even if it entails some review of the presence of a "public purpose" or the "character of the governmental action," *id.* at 485-93, does not permit heightened scrutiny of a statute's effectiveness. *Keystone* involved a Just Compensation Clause challenge to a Pennsylvania statute that limited coal-mining activity. Although the court split sharply on the ultimate merits, it unanimously adopted a deferential standard of review. The majority upheld the statute because the Act "plainly [sought] to further" the substantial "public interest in preventing activities similar to public nuisances." *Id.* at 492. The dissent, though persuaded

that there was a compensable taking, noted that "our inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation," *id.* at 470 n.3 (Rehnquist, C.J., dissenting). Rather, "'whether *in fact* the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature *rationally could have believed* that the [Act] would promote its objective.'" *Id.* (quoting *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 242 (1984) (quoting in turn *Western and Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 671-72 (1981))).[6] The majority expressly agreed with this statement. 480 U.S. at 487 n.16. Thus, none of the Justices suggested that a more rigorous standard of review might be appropriate in a Just Compensation Clause challenge to a generally-applicable state statute.

The Ninth Circuit attempted to locate such a rigorous requirement in *Del Monte Dunes*, which in fact stands for precisely the opposite proposition. There, the Court rejected the application of the "rough-proportionality" Takings Clause test – which it had described as requiring "intermediate" scrutiny – "beyond the special context of exactions" at issue in *Nollan* and *Dolan*. *See Dolan*, 512 U.S. at 390. Such heightened scrutiny, the Court held, was "inapposite" to a challenge "based not on exactions but on denial of development." 526 U.S. at 703. It is presumably even more "inapposite" to a challenge to generally-applicable regulation of the sort at issue in the present case.

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6. The Ninth Circuit discounted Chief Justice Rehnquist's statements because, in its view, *Keystone* involved a physical taking. 363 F.3d at 855; 224 F.3d at 1034. The Ninth Circuit, however, plainly misread *Keystone*. *See* 480 U.S. at 488-89 ("This case, of course, involves land use regulation, not a physical appropriation of petitioners' property.").

III. Principles Of Federalism Require Deferential Judicial Review Of State Economic And Social Legislation

The historic respect for States under our system of federalism calls for the rejection of a stringent new standard of review imposed by the Ninth Circuit. Review under this new test would not be limited to the varying legislative attempts, such as that made by Hawaii in Act 257, to address the control of oil refiners over retail sales of gasoline. *See Exxon*, 437 U.S. at 128 (noting numerous statutes and legislative proposals in this area). Nor would review be limited to legislative efforts to address related concerns that franchisors in general can take advantage of franchisees after the latter have made significant investments into their properties.[7] Rather, a vast array of State enactments – such as tort reform efforts, health care measures, gaming control statutes, environmental protection enactments and vehicle safety laws, to name just a few – would be subject to *de novo* reconsideration by federal courts without any deference to democratically-elected state legislatures. An enhanced "substantially advance" test along the lines envisioned by the Ninth Circuit would improperly turn the

7. *See, e.g.*, Ark. Code Ann. § 4-72-204 (2003); Cal. Bus. & Prof. Code §§ 20020, 20021 (2004); Cal. Corp. Code §§ 31113, 31115 (2004); Conn. Gen. Stat. Ann. §§ 42-133f, 42-133l (2004); Del. Code Ann. tit. 6, §§ 2552, 2554 (2004); Haw. Rev. Stat. Ann. § 482E-6(2)(H),(3) (2003); 815 Ill. Comp. Stat. Ann. 705/19, 705/20 (2004); Ind. Code Ann. §§ 23-2-2.5-12, 23-2-2.5-14, 23-2-2.7-1 (2004); Iowa Code Ann. §§ 523H.7, 523H.8 (2004); Mich. Comp. Laws Ann. § 445.1527 (2004); Minn. Stat. Ann. § 80C.14 (2003); Neb. Rev. Stat. § 87-404 (2004); N.J. Stat. Ann. § 56:10-5 (2004); P.R. Laws Ann. tit. 10, §§ 278, 278a (2002); V.I. Code Ann. tit. 12A, § 132 (2004); Va. Code Ann. § 13.1-564 (2004); Wash. Rev. Code Ann. §§ 19.100.180 (2004); and Wis. Stat. Ann. § 135.03 (2003).

federal judiciary into a "superlegislature" (*Ferguson v. Skrupa*, 372 U.S. 726, 731 (1963)), or "a super zoning board or a zoning board of appeals" (*Raskiewicz v. Town of New Boston*, 754 F.2d 38, 44 (1st Cir.), *cert. denied*, 474 U.S. 845 (1985)), and thereby undermine the "strong policy considerations [that] favor local resolution of land-use disputes," *Taylor Inv., Ltd. v. Upper Darby Township*, 983 F.2d 1285, 1291 (3d Cir.), *cert. denied*, 510 U.S. 914 (1993).

Allowing federal courts to second-guess state legislatures under the Ninth Circuit's exacting standard of review will also inhibit the States' ability to develop flexible responses to the many problems they face. The federal system encourages states to experiment with a variety of policy responses to current challenges. *See, e.g., American Federation of Labor v. American Sash and Door* Co., 335 U.S. 538, 553 (1949) (Frankfurter, J., concurring); *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.") (Brandeis, J., dissenting). As the problems they face evolve and grow, the States must retain the flexibility to develop policies to address them, even before a state-wide, regional, or national consensus develops. That is why the States are accorded broad police powers. Consistent with these police powers, courts have subjected generally-applicable legislation that does not involve suspect classifications or fundamental rights to rationality review under the Equal Protection and Due Process Clauses. To subject generally-applicable statutes and regulations to additional, enhanced scrutiny as part of regulatory takings review will inhibit such experimentation and delay development of State policy.

This Court has repeatedly rejected the type of intrusive judicial review authorized by the court below. Since the repudiation of *Lochner v. New* York, 198 U.S. 45 (1905), some seventy years ago, it has recognized that state legislatures have the discretion necessary to craft reasonable solutions to evolving problems. *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937). "Under the system of government created by our Constitution, it is up to legislatures, not courts, to decide on the wisdom and utility of legislation." *Ferguson*, 372 U.S. at 729. This Court has accordingly held that "state legislatures have constitutional authority to experiment with new techniques; they are entitled to their own standard of the public welfare; they may within extremely broad limits control practices in the business-labor field." *Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421, 423 (1952). This Court should now confirm that the States, as well as localities, may continue to do so without being second-guessed by the courts under the Just Compensation Clause.

CONCLUSION

For the foregoing reasons, this Court should reverse the decision of the Ninth Circuit Court of Appeals.

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No. 04-163

In the

Supreme Court of the United States

LINDA LINGLE, Governor of the State of Hawaii, and MARK J. BENNETT, Attorney General of the State of Hawaii,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION; GENE CASHMAN; ATHENA SUTSOS; WESTERN MANUFACTURED HOUSING COMMUNITIES ASSOCIATION; and DEFENDERS OF PROPERTY RIGHTS IN SUPPORT OF RESPONDENT CHEVRON USA, INC.

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QUESTIONS PRESENTED

1. Should this Court reverse 24 years of precedent and abandon what it has called its "general test" of liability for a regulatory taking: whether a land-use regulation substantially advances legitimate state interests?

2. Should this Court continue to afford meaningful protection to individual rights guaranteed under the Takings Clause of the Fifth Amendment, by applying mid-level scrutiny to land-use regulations challenged under the "substantial advancement" test, as mandated by *Nollan v. California Coastal Commission* and its progeny?

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IDENTITY AND INTEREST OF AMICI CURIAE[1]

Pacific Legal Foundation (PLF) is the largest and most experienced public interest legal foundation of its kind in the United States. Founded over 30 years ago, PLF is a nonprofit, tax-exempt corporation organized under the laws of California for the purpose of litigating matters affecting the public interest at all levels of state and federal courts. Representing the views of tens of thousands of members and supporters nationwide, PLF is an advocate of individual rights, including the fundamental right to own and make productive use of private property. PLF has appeared before this Court in many high-profile cases arising under the Takings Clause of the Fifth Amendment to the United States Constitution. PLF attorneys were counsel of record in *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001); *Suitum v. Tahoe Regional Planning Agency*, 520 U.S. 725 (1997); and *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987). PLF has also participated as amicus curiae in nearly every major real property takings case heard by this Court in the last two decades.

Gene Cashman and Athena Sutsos are owners of small mobile home parks in Cotati, California, which are subject to that city's mobile home rent control scheme. Regulations of this type enable park tenants (who dominate the political process in small towns like Cotati) to capture cash windfalls representing part of the value of the mobile home parks in which they reside. By enacting rent control and promptly selling their mobile homes in rent controlled parks, these

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[1] All parties have consented to the filing of this brief under the terms of general consent letters, which have been filed by the parties with the Clerk of the Court. No counsel for any party authored this brief in whole or in part, and no person or entity made a monetary contribution specifically for the preparation or submission of this brief.

tenants acquire part of the value of the park owners' property, with no benefit accruing to the community as a whole. Cashman and Sutsos successfully challenged this scheme as a regulatory taking in *Cashman v. City of Cotati*, 374 F.3d 887 (9th Cir. 2004), a decision that relies on a straightforward application of the substantial advancement takings test from *Agins v. City of Tiburon*. Cotati's petition for rehearing or rehearing en banc is currently pending before the Ninth Circuit, where it awaits this Court's disposition of the present case.

Western Manufactured Housing Communities Association represents 1,700 mobile home park operators. It is the largest such organization in the United States. The Association has a vital interest in the issues raised by this case because its members face those same issues continuously—particularly in California, where mobile home rent control ordinances are ubiquitous and the state courts are inhospitable to the claims of park owners to a fair return on their investments. In most cases, these owners' only meaningful avenue of relief from confiscatory rent regulations is to pursue regulatory takings claims in federal court, relying on the "substantial advancement" prong of *Agins v. City of Tiburon*. If this Court rejects or significantly restricts the applicability of the substantial advancement standard, the Association's members will have no effective judicial remedy for the systematic confiscation of the value of their property via mobile home park rent control.

Defenders of Property Rights (Defenders) is the only national legal defense foundation dedicated exclusively to protecting private property rights. Based in Washington, D.C., Defenders was founded as a nonprofit, public interest legal foundation in 1991. Its mission is to protect vigorously those rights considered essential by the framers of the Constitution, and to promote a better understanding of the relationship between private property rights and individual liberty. Defenders engages in litigation across the country on behalf of

its thousands of members and the public interest to prevent government incursion into protections guaranteed by the Bill of Rights. Since its inception, Defenders has participated in every major property rights case before this Court, including *Palazzolo v. Rhode Island*, 533 U.S. 606; *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers*, 531 U.S. 159 (2001); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999); *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998); *Suitum v. Tahoe Regional Planning Agency*, 520 U.S. 725; *Bennett v. Spear*, 520 U.S. 154 (1997); *Dolan v. City of Tigard*, 512 U.S. 374 (1994); *Keene Corp. v. United States*, 508 U.S. 200 (1993); and *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992).

Counsel for amici are familiar with the issues in this case and have reviewed the Brief for Petitioners (Pet. Brf.) and the amicus brief filed in this matter by the Solicitor General. Amici believe these briefs incorporate fundamental doctrinal errors based upon misinterpretations of this Court's regulatory takings jurisprudence. Amici further believe that their experience with regulatory regimes such as the rent control statute at issue in this case, together with their litigation experience in the issues involved, their special expertise in regulatory takings law, and their public interest perspective will assist this Court in resolving the important issues presented by this case.

INTRODUCTION AND STATEMENT OF THE CASE

Twenty-four years ago, in *Agins v. City of Tiburon*, 447 U.S. 255 (1980), a case involving a facial challenge to a residential zoning ordinance, this Court explained the criteria for finding such measures unconstitutional under the Takings Clause of the Fifth Amendment:

> The application of a general zoning law to particular property effects a taking if the ordinance does not

> substantially advance legitimate state interests . . . or denies an owner economically viable use of his land.

Id. at 260. Since 1980, this Court has frequently reiterated and applied the "substantial advancement" prong of *Agins* as a test for regulatory takings in cases involving a wide variety of both facial and as-applied challenges to legislative enactments and regulatory actions. *See Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 535 U.S. 302, 334 (2002); *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*,526 U.S. 687 at 704, *Dolan v. City of Tigard*, 512 U.S. 374 at 385; *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 at 1016; *Yee v. City of Escondido*, 503 U.S. 519, 534 (1992); *Keystone Bituminous Coal Ass'n. v. DeBenedictis*, 480 U.S. 470, 485 (1987); *Nollan v. California Coastal Commission,* 483 U.S. 825 at 834; *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985). This standard is so thoroughly ingrained in this Court's protection of individual rights guaranteed under the Fifth Amendment it has been described as the Court's "general test" for a regulatory taking. *City of Monterey*, 526 U.S. at 704.

The present case involves the application of the substantial advancement test by the Ninth Circuit Court of Appeals to strike down a state law that controls the rent oil companies may charge to the lessees of their service stations. The ostensible purpose of the statute, Haw. Rev. Stat. § 486H-10.4, is to hold down the price of gasoline to consumers. Plaintiff-Appellee Chevron U.S.A., Inc. (Chevron), sued to have the law declared unconstitutional as an uncompensated taking of its property in violation of the Fifth and Fourteenth Amendments to the United States Constitution.

Chevron initially prevailed on a motion for summary judgment, the trial court finding that the rent control scheme failed to substantially advance legitimate state interests as a matter of law, and therefore violated the Takings Clause. On

remand by the Ninth Circuit, a trial was held which again resulted in a judgment that the rent control law effected a regulatory taking under the substantial advancement standard. The trial court found, *inter alia*, that controlling Chevron's station rents will not, as a factual matter, advance the law's objective of reducing gasoline prices. Instead, the operative effect of the law is merely to create a premium in the value of rent-controlled service stations, that Chevron's lessees can capture by selling their leases.

On certiorari to this Court, the State and its amici argue that the trial court's inquiry into whether Haw. Rev. Stat. § 486H-10.4 substantially advances legitimate state interests—which has long been recognized as the appropriate standard for regulatory takings claims of this sort—should in fact be regarded as a substantive due process inquiry. Similarly, rejecting 17 years of Supreme Court precedent, the State and its amici urge this Court to return to the deferential review of constitutionally suspect regulations that prevailed prior to *Nollan.*

ARGUMENT

I

WHETHER A LAND-USE REGULATION SUBSTANTIALLY ADVANCES A LEGITIMATE STATE INTEREST HAS LONG BEEN—AND SHOULD REMAIN—THIS COURT'S "GENERAL TEST" FOR A REGULATORY TAKING

A. The Substantial Advancement Test Is a Settled, Long-Established, and Coherent Regulatory Takings Standard

The State of Hawaii and its amicus, the Solicitor General, have assumed the burden of persuading this Court to jettison 24 years of precedent and repudiate the first prong of *Agins v. City*

of Tiburon, which holds that "[t]he application of a general zoning law to particular property effects a taking if the ordinance does not substantially advance legitimate state interests." 447 U.S. at 260. Such a sharp break with this Court's historical jurisprudence would deal a crushing blow to constitutional protections of the rights of property owners. Moreover, the arguments that are advanced in support of this radical revisionism are not supported by careful analysis.

The core insight advanced by the State and the Solicitor General amounts to nothing more than the self-evident proposition that, in setting forth the first prong of its takings test, the *Agins* Court cited to *Nectow v. City of Cambridge*, 277 U.S. 183 (1928), a challenge to a zoning ordinance brought under the Fourteenth Amendment's Due Process Clause. The State's implicit reasoning is that, because the language of "substantial advancement" was previously used in a due process case, when that terminology is subsequently cited in a regulatory takings decision, the cited language must remain a due process standard.

The difficulties with this position are manifold. Perhaps most crucially, it assumes a doctrinal fastidiousness that never exists in the real world of constitutional adjudication. Standards and criteria developed in cases brought under one Constitutional provision are commonly brought to bear on issues implicating completely different clauses or even Amendments, without prompting analysts to protest that these tests must remain permanently and solely wed to the applications in which the Court first found them useful. The use of evaluative standards that seem similar or even identical does not imply that the Court has confused the Free Exercise Clause with the Equal Protection Clause, or that it has chosen to use the same test for both clauses by mistake. *See, e.g., Nollan*, 483 U.S. at 834 n.3:

> There is no reason to believe (and the language of our cases gives some reason to disbelieve) that so long as the regulation of property is at issue, the standards for takings challenges, due process challenges, and equal protection challenges are identical, any more than there is any reason to believe that so long as the regulation of speech is at issue, the standards for due process challenges, equal protection challenges, and First Amendment challenges are identical.

The migration of standards between the Takings and Due Process Clauses is especially unremarkable, given the close historical relationship between the two provisions. On its own terms, the Takings Clause—like the rest of the Bill of Rights—applies only against the federal government. It was not until the Fifth Amendment was deemed incorporated into the Fourteenth Amendment's Due Process Clause in 1897 that it became possible to plead a cause of action against a state or local governmental entity under the Takings Clause. *See Chicago, B. & Q. R. Co. v. Chicago*, 166 U.S. 226, 239 (1897).

In the first decades following this development, the fact that nearly every takings claim also entailed a due process violation led to a substantial conflation of terminology. As Justice Stevens has explained, the Court in the early years of the 20th century had "fused the two express constitutional restrictions on any state interference with private property that property shall not be taken without due process nor for a public purpose without just compensation, into a single standard," *Moore v. City of East Cleveland*, 431 U.S. 494, 514 (1997) (Stevens, J., concurring), and "this principle was applied in *Nectow*." *Id.*

Thus, far from being surprised that *Nectow* was cited in *Agins*, we should be surprised if it were not cited in other regulatory takings cases—and, in fact, it has been. Even the

recently proclaimed "polestar" of the Court's regulatory takings jurisprudence, *Penn Central*, cites *Nectow* as authority. *See Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 127 (1978) (citing *Nectow*, 227 U.S. at 188). Of course, the same objections can be (and have been) raised to *Nectow*'s appearance in *Penn Central* as to its citation in *Agins*, but the argument becomes more strained as the underlying enterprise takes on more clarity. *See* John D. Echeverria, *Does a Regulation That Fails to Advance a Legitimate Governmental Interest Result in a Regulatory Taking?*, 29 Envtl. L. 853, 857-58 (1999):

> In *Penn Central*, the Court relied upon due process, not takings, precedents .... *Nectow* patently was not a takings case, but instead involved a due process claim that the ordinance 'deprived [the owner] of his property without due process of law in contravention of the Fourteenth Amendment.'

It is one thing to cling to a formalistic insistence that each constitutional provision should have its own neatly compartmentalized set of doctrines, but it is something else again to insist that violating these largely imaginary doctrinal boundaries is grounds for jettisoning this Court's entire corpus of regulatory takings law—which is, in fact, precisely the enterprise the State and the Solicitor General have undertaken.

B. The Pedigree of the Substantial Advancement Test Stretches Back Through *Penn Central* to *Pennsylvania Coal*

In any event, it isn't necessary to go back to *Nectow* to trace the lineage of *Agins*' two-pronged takings test, since its immediate progenitor is much closer at hand. It has long been recognized that the takings standards set out in *Agins* differ only in terminology from *Penn Central*'s focus on "the character of the governmental action" and "[t]he economic impact of the regulation on the claimant." 438 U.S. at 124. Conceptually, the

Agins and *Penn Central* standards are equivalent. *See* John D. Echeverria, *Does a Regulation That Fails to Advance a Legitimate Governmental Interest Result in a Regulatory Taking?*, 29 Envtl. L. at 855:

> More than twenty years ago, in *Penn Central Transportation Co. v. New York City* (*Penn Central*), the Court stated that "a use restriction may constitute a 'taking' if [it is] not reasonably necessary to the effectuation of a substantial government purpose." Two years later, in *Agins v. City of Tiburon*, the Court said essentially the same thing: a government action "effects a taking" if it "does not substantially advance legitimate state interests."

See also Jordan C. Kahn, *Lake Tahoe Clarity and Takings Jurisprudence: The Supreme Court Advances Land Use Planning in* Tahoe-Sierra, 26-Fall *Environs* 33, 57 n.160 (2002) ("the 'character of government action' factor in the *Penn Central* analysis . . . includes a consideration of whether the regulation at issue does or 'does not substantially advance legitimate state interests' "); Victoria Sutton, *Constitutional Taking Doctrine—Did* Lucas *Really Make a Difference*?, 18 Pace Envtl. L. Rev. 505, 509 (2001) (characterizing *Penn Central*'s "character of the government action" test as "the progenitor of the 'substantially advances legitimate state interests' test articulated two years later in *Agins*"); R. S. Radford, *Why Rent Control Is a Regulatory Taking*, 6 Fordham Envtl. L.J. 755, 757 (1995) ("In *Agins*, the two-part *Penn Central* inquiry was recast in terms of whether the challenged measure: (1) substantially advances legitimate state interests; or (2) denies the owner economically viable use of the land.").

Justice Brennan advanced the clearest statement of the equivalence (indeed, the virtual identity) of the standards set out by the two cases in his *Nollan* dissent:

> Our phraseology may differ slightly from case to case—*e.g.*, regulation must "substantially advance," *Agins v. Tiburon*, 447 U.S. 255, 260 (1980), or be "reasonably necessary to," *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 127, (1978), the government's end. *These minor differences cannot, however, obscure the fact that the inquiry in each case is the same.*

Nollan, 483 U.S. at 845 (Brennan, J. dissenting) (emphasis added). More recently, Justice Scalia's majority opinion in *Lucas* provided a further refutation of the view that *Agins*' first prong marked a departure from the Court's established takings jurisprudence:

> "Harmful or noxious use" analysis was, in other words, simply the progenitor of our more contemporary statements that "land-use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests' ". . . . *Nollan, supra*, 483 U.S. at 834 (quoting *Agins v. Tiburon*, 447 U.S. at 260); *see also Penn Central Transportation Co., supra*, 438 U.S. at 127; *Euclid v. Ambler Realty Co.*, 272 U.S. 365, 387-388, (1926).

Lucas, 505 U.S. at 1023-24.

In fact, as this Court has noted, Agins' two-pronged takings inquiry can be traced back not just to *Penn Central*, but to the very font of its modern takings jurisprudence, *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922):

> Justice Holmes rested on two propositions, both critical to the Court's decision. First, because it served only private interests, not health or safety, the Kohler Act could not be "sustained as an exercise of the police power." Second, the statute made it "commercially impracticable" to mine "certain coal" in the areas affected by the Kohler Act.

Keystone, 480 U.S. at 484. *See also* George Skouras, *Takings Law and the Supreme Court: Judicial Oversight of the Regulatory State's Acquisition, Use and Control of Private Property* 117 (1998) ("Justice Holmes, working through balancing tests, established a set of criteria that continue unabated until this day. . . . The criteria in *Pennsylvania Coal* were refined in *Penn Central*.").

The doctrinal equivalence of *Penn Central* and *Agins* is acknowledged by the more perceptive critics of the substantial advancement standard, but this only serves to shift their objections back a step—to *Penn Central* itself, or in extreme cases, all the way back to *Pennsylvania Coal*. *See, e.g.*, John D. Echeverria, *Does a Regulation That Fails to Advance a Legitimate Governmental Interest Result in a Regulatory Taking?*, at 857-58. With this shift, however, the very consistency of their argument undermines its credibility. If *Agins*' first prong were, as is sometimes claimed, an isolated anomaly, it is arguably not too far-fetched to suppose that the substantial advancement standard might be dismissed as some sort of doctrinal slip of the pen. But when we realize we are dealing with a standard that has been deeply ingrained into the entire corpus of regulatory takings law from the beginning, nothing less than the modern Court's protection of the constitutionally-guaranteed rights of property owners hangs in the balance.

C. No Phantom "Majority" of the *Eastern Enterprises* (Or Any Other) Court Has Repudiated the Substantial Advancement Standard

In the face of this Court's long-established use of the substantial advancement test to resolve regulatory takings claims, the State invokes a phantom "majority" that supposedly backed away from this standard in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998). *See* Pet. Brf. at 30-32. This remarkable

claim, which is recycled from the State's unsuccessful brief to the Ninth Circuit, is simply ungrounded in reality.

In *Eastern*, Justice O'Connor's plurality opinion found a statute's creation of retroactive financial liability to be unconstitutional under the Takings Clause. The plurality did not cite to *Agins*, nor did it decide the case under the substantial advancement standard. Instead, Justice O'Connor applied a straightforward *Penn Central* analysis, finding that the character of the regulation was such that it "singles out certain employers" based on long-past activities, thereby "implicat[ing] fundamental principles of fairness underlying the Takings Clause." *Id* at 537.

Concurring in the result, Justice Kennedy agreed that the statute was unconstitutional as applied to Eastern, but he would strike it down "as contrary to essential due process principles, without regard to the Takings Clause of the Fifth Amendment." *Id.* at 539 (Kennedy, J., concurring in the judgment and dissenting in part). The crux of Justice Kennedy's concern was that the Act did not directly impinge upon any identifiable property interest. Without a direct link between the impact of the law and "a specific property right or interest" protected by the Fifth Amendment, *id.* at 541, Justice Kennedy felt the Takings Clause was not implicated. In this context, he worried that

> [t]he imprecision of our regulatory takings doctrine does open the door to normative considerations about the wisdom of government decisions. See, *e.g., Agins v. City of Tiburon*, 447 U.S. at 260 (zoning constitutes a taking if it does not "substantially advance legitimate state interests").

Id. at 545. But of course, *Agins* ***did*** involve governmental interference with a traditional, constitutionally cognizable property interest, and therefore presumably escaped Justice

Kennedy's concern about the applicability of the Takings Clause.

Writing for a four-Justice dissent, Justice Breyer agreed that "[t]he Constitution's Takings Clause does not apply." *Id.* at 554 (Breyer, J., dissenting). Like Justice Kennedy, the dissent was troubled by the plurality's application of the Takings Clause to a case that

> involves not an interest in physical or intellectual property, but an ordinary liability to pay money, and not to the Government, but to third parties.

Id. Like the plurality, however, the dissent did not address the substantial advancement standard.

In view of these facts, the State's present effort to concoct a five-Justice "majority" out of a concurrence and a dissent—including four Justices who did not so much as mention the substantial advancement issue—seems puckish at best. That Justice Kennedy's concurrence in *Eastern Enterprises* cannot be construed as a general rejection of the substantial advancement takings standard is evident from the opinion of the Court he drafted just eleven months later in *City of Monterey v. Del Monte Dunes at Monterey*, 526 U.S. 687. In *City of Monterey*, a property owner brought a regulatory takings suit based on a city's repeated, unreasonable denials of development permits. *See id.* at 695-98. The case went to a jury on a strange amalgam of *Agins* and *Lucas*: the trial court instructed the panel that takings liability should be found either if the permit denials deprived the owner of ***all*** economically viable use of the property, or if the city's actions did not "substantially advance a legitimate public purpose." *See id.* at 700. As a practical matter, only the latter criterion provided a realistic basis for takings liability, since the plaintiffs had sold the regulated property for $4.5 million. The jury returned a general verdict of liability, *see id.* at 701, in effect finding a compensable taking because the City's successive denials of the plaintiff's

permit applications failed to substantially advance legitimate governmental interests. *See, e.g.*, Daniel R. Mandelker & John M. Payne, *Planning and Control of Land Development: Cases and Materials* 119 (5th ed. 2001) (the *City of Monterey* trial court "essentially put the case to the jury on the first prong of *Agins*, and because it was a general verdict, it had to be presumed that the jury had decided on this theory").

In affirming the finding of a taking, Justice Kennedy's opinion for the Court repeatedly expressed its satisfaction with the jury instructions, and with the substantial advancement inquiry serving as the basis for takings liability. *See City of Monterey*, 526 U.S. at 702-07. The Supreme Court's answer to the City of Monterey's question was clear: "the trial court's instructions are consistent with our previous general discussions of regulatory takings liability." 526 U.S. at 704. In other words, *Eastern Enterprises* notwithstanding, Justice Kennedy's opinion in *City of Monterey* expressly reiterated this Court's traditional understanding that takings liability may properly be grounded on the failure of land-use regulations to substantially advance legitimate state interests, going so far as to characterize this as ***"the general test for regulatory takings liability."*** *Id.* (emphasis added).

With the exception of the State's counsel, virtually all commentators have acknowledged that *City of Monterey* reaffirms the substantial advancement test as a central element of the Supreme Court's regulatory takings jurisprudence. *See, e.g.*, Richard J. Lazarus, *Restoring What's Environmental About Environmental Law in the Supreme Court*, 47 UCLA L. Rev. 703, 720 n.89 (2000) ("[t]he ruling in favor of the property owner in *City of Monterey* is especially significant because it represents the first occasion that the Court has ever upheld a regulatory takings claim based just on the so-called first prong of the regulatory takings test announced in *Agins v. City of Tiburon*). This understanding was underscored in the Court's most recent regulatory takings decision, *Tahoe-Sierra*

Preservation Council v. Tahoe Regional Planning Agency, 535 U.S. 302, in which the Court enumerated seven alternative theories under which a development moratorium could give rise to a regulatory taking, including:

> Sixth, apart from the District Court's finding that TRPA's actions represented a proportional response to a serious risk of harm to the lake, ***petitioners might have argued that the moratoria did not substantially advance a legitimate state interest, see Agins and Monterey.***

Id. at 334 (emphasis added).

In short, in the half-decade since the Court's fragmented decision in *Eastern Enterprises,* every Justice has written or joined opinions applying, upholding, or expressly reaffirming the general applicability of the substantial advancement test to regulatory takings. Thus, as of its last major land-use takings decision, the Court is unanimous in its understanding that a land-use regulation that fails to substantially advance legitimate state interests ***does*** result in a regulatory taking.

II

REGULATORY TAKINGS CLAIMS BROUGHT UNDER THE SUBSTANTIAL ADVANCEMENT STANDARD MUST RECEIVE A HIGHER LEVEL OF JUDICIAL REVIEW THAN SUBSTANTIVE DUE PROCESS CLAIMS

As a corollary to their efforts to relegate the substantial advancement takings test to a toothless variety of due process review, the State and its amici also seek to undermine the level of scrutiny required by this Court in regulatory takings cases. *See* Pet. Brf. at 37-50. At issue is *Nollan*'s footnote 3, which has been under continuous attack by virtually every level of the

regulatory bureaucracy since the day it was enunciated, over 17 years ago:

> [O]ur opinions do not establish that [takings] standards are the same as those applied to due process or equal protection claims. To the contrary, . . . [w]e have required that the regulation "substantially advance" the "legitimate state interest" sought to be achieved, not that "the State '*could rationally have decided*' that the measure adopted might achieve the State's objective."

Nollan, 483 U.S. at 834 n.3 (citations omitted).

Obviously, substantial advancement takings claims cannot *both* be subjected to deferential review *and* be expressly distinguished from the level of scrutiny applied in due process or equal protection claims. The theoretical significance of this Court's requirement of heightened scrutiny has been clear to commentators from the outset. *See, e.g.*, Mark W. Cordes, *Legal Limits on Development Exactions: Responding to* Nollan *and* Dolan, 15 N. Ill. U. L. Rev. 513, 534 (1995) (noting that the *Dolan* "Court's analysis demonstrated a seriousness of review to protect [against] unjustified intrusions on property interests"); Page Carroccia Dringman, Comment, *Regulatory Takings: The Search for a Definitive Standard*, 55 Mont. L. Rev. 245, 253 (1994) ("*Nollan v. California Coastal Commission* signaled the United States Supreme Court's movement away from a 'rubber stamp' or superficial application of the rational basis test to a more rigorous standard of review").

This Court's application of heightened scrutiny under *Agins*' first prong is not an aberration, nor is it an arbitrary or mistaken appendage to takings law. Rather, the requirement of an elevated standard of review is implied by the very existence of a cause of action for regulatory takings. As the *Tahoe-Sierra* Court noted, regulatory takings differ in nature from physical

occupations or invasions, either directly by the government or by third parties acting under governmental authority. *See* 535 U.S. at 322-23. It is this very difference that gives rise to the need for heightened scrutiny of regulatory takings claims. Physical invasions or occupations of private property by the state are normally obvious to a fact finder employing even a minimal standard of review. The only question in such cases is whether just compensation has been paid—again, an inquiry that can be conducted on the level of an evidentiary hearing, without need for probing review on the part of the court. The situation is completely different when the government, inadvertently or by design, accomplishes the same effect as if it had taken title to private property, but without acknowledging either the usurpation or the requirement to compensate. As the Ninth Circuit Court of Appeals has observed:

> It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.

Hall v. City of Santa Barbara, 833 F.2d 1270, 1280 n.25 (1986). In the successive two-part inquiries set out in *Pennsylvania Coal*, *Penn Central*, and *Agins*, this Court has recognized the necessity of examining the nature and impact of challenged regulations to determine whether they are the functional equivalent of seizures, pressing private property "into some form of public service under the guise of mitigating serious public harm," but without payment of compensation. *Lucas*, 505 U.S. at 1018. Such an inquiry, by definition, requires going behind the surface of the regulatory rationale—i.e., it requires an elevated level of scrutiny.

But the heightened scrutiny requirement implicit in *Agins*' first prong does not flow automatically from the mere invocation of the standard; applying meaningful review of state

action requires an act of judicial will. This responsibility can easily be evaded. The most common way to convert the substantial advancement standard into deferential review is to characterize it as merely requiring a rational relationship between regulatory ends and means—since requiring means-ends consistency is just another way of describing rational basis review.

In *Nollan*, this Court did inquire into the relationship between regulatory ends and means. Far more important, however, was *Nollan*'s emphasis on the need for a close *causal* nexus between the burdens imposed by the regulations, and the social costs that would otherwise be imposed by the property's unregulated use. As Professor McUsic points out,

> [The *Nollan*] Court described the "substantially advance" test as one that examines the proportionate relationship between the amount of public harm caused by the owner and the regulatory burden imposed: a cause-effect test. . . .
>
> The second meaning of the substantially advance requirement—the cause-effect test—focuses on whether the burden of a regulation is properly placed on a particular owner.

Molly S. McUsic, *Looking Inside Out: Institutional Analysis and the Problem of Takings*, 92 Nw. U. L. Rev. 591, 602 (1998). It is the requirement of a *cause-effect* nexus, not just an ends-means fit, that offers real protection against the imposition of unjustified or disproportionate burdens on individual property owners. This fact was emphasized by Justice Scalia in his separate opinion in *Pennell v. City of San Jose*, 485 U.S. 1 (1988), in which he explained:

> Traditional land-use regulation (short of that which totally destroys the economic value of property) does not violate this [substantial advancement] principle

> because there is ***a cause-and-effect relationship*** between the property use restricted by the regulation and the social evil that the regulation seeks to remedy.

Id. at 20 (Scalia, J., concurring in part and dissenting in part).

The crucial importance of applying heightened scrutiny in conjunction with the substantial advancement test has never been more dramatically illustrated than by a pair of cases springing from a common factual setting: *Mayhew v. Town of Sunnyvale*, 964 S.W. 2d 922 (Tex. 1998), and *Dews v. Town of Sunnyvale*, 109 F. Supp. 2d 526 (N.D. Tex. 2000). In *Mayhew*, a proposed residential development was prohibited after years of negotiations on the grounds that it would be inconsistent with the town's minimum lot size requirements. The property owners sued, alleging that the town's actions failed to substantially advance legitimate state interests. A trial court agreed, finding that the town's denial of the Mayhews' project "does not bear any factual relationship to valid planning principles or objectives." 964 S.W.2d at 927. The state supreme court reversed, applying a deferential level of scrutiny to conclude that the permit denial advanced Sunnyvale's legitimate interest in maintaining "the overall character of the community and the unique character and lifestyle of the Town." *Id.* at 935.

Following a second permit denial, the Mayhews' successors in interest sued in federal district court on equal protection grounds. In contrast to the Texas Supreme Court, the federal judge applied a heightened standard of review and found the town's building restrictions were racially motivated—designed primarily to prevent minorities from moving into the community. *Dews*, 109 F. Supp. 2d at 568-71. In other words, by probing beneath the town's superficial rationale, the federal court was able to determine that what local officials meant by preserving the "unique character and lifestyle" of the town, was keeping it White. The official rationalizations, unquestioningly

accepted under the state court's deferential review, were found to have comprised merely "a facade in an unsuccessful attempt to shield [the Town] from liability for excluding both African-Americans and affordable housing from Sunnyvale." *Id.* at 572.

This sobering example should not be taken to mean that governmental bad faith is the sole rationale for a meaningful standard of review in takings cases. The nature and effect of restrictive land-use regulations must be subjected to more than bare rationality review if courts are to determine whether *any* such measure effectively takes private property for public use, no matter how well-intentioned it may be. Nevertheless, as was clear to the Founders and has been demonstrated repeatedly throughout our Nation's history, good faith on the part of the regulatory bureaucracy can never be presumed. Abandoning heightened scrutiny for the deferential review urged on this Court by the State and the Solicitor General would be tantamount to shifting every property owner in the United States from the position of the plaintiffs in *Dews*, to those in *Mayhew*.

III

THIS COURT'S SUBSTANTIAL ADVANCEMENT TAKINGS ANALYSIS IS ESSENTIAL TO EXPOSE AND REMEDY NAKED MAJORITARIAN RENT SEEKING, SUCH AS IS EVIDENCED IN MOBILE HOME PARK RENT CONTROL

Mobile home park rent control offers a paradigm example of the capture of local legislative processes by rent-seeking majorities, whose eagerness to transfer the assets of property-owning minorities to themselves cannot be checked except by vigorous judicial review. This type of regulation embodies an especially malevolent breakdown in the political process, because once tenant-lobbyist-legislators succeed in imposing controls, they can immediately "cash out," capturing the full

present value of below-market rents by selling their mobile home coaches in place in rent-controlled parks. *See, e.g.*, Richard A. Epstein, Yee v. City of Escondido: *The Supreme Court Strikes Out Again*, 26 Loy. L.A. L. Rev. 3, 10 (1992) (Mobile home park rent control "increases the returns to local renters from the passage of the rent control statute by allowing them to capture the full stream of future periodic expropriations from the landlord.").

The mechanism that facilitates this is both obvious and simple enough to have been employed by hundreds of tenant-dominated localities in California. Mobile home park tenants normally own their own coaches, which sit on "pads" owned by the mobile home park. Their housing costs are therefore the sum of mortgage payments on the coach, plus rent payments on the underlying land. Rent control obviously reduces the second component, but in addition, the assurance of below-market rents in the future is capitalized into the resale value of the coach. This "premium," or incremental resale value attributable to rent control, represents the present value of the future stream of financial benefits tenants will receive from the regulations, discounted at an appropriate rate. It is an amount equal to the decrease in value of the underlying land because of rent control, and therefore is the equivalent of a direct cash transfer from park owner to tenant, effected via the legislative process. *See, e.g.*, Werner Z. Hirsch & Joel C. Hirsch, *Legal-Economic Analysis of Rent Controls in a Mobile Home Context: Placement Values and Vacancy Decontrol*, 35 UCLA L. Rev. 399, 423-24 (1988).

The capitalization into coach prices of the monetary value of mobile home park rent control has been well documented empirically. As long ago as 1988, research by the internationally reputed economist, Dr. Werner Hirsch, showed that California mobile home park tenants used rent control to transfer to themselves a part of the value of mobile home parks equal to 32% of the resale value of their coaches. *See* Werner

Z. Hirsch, *An Inquiry into Effects of Mobile Home Park Rent Control*, 24 J. Urb. Econ. 212, 223-24 (1988). A second study published more than a decade later confirmed that these regulations were still being successfully used by tenant majorities to transfer to themselves the cash value of mobile home park assets. *See* Werner Z. Hirsch & Anthony M. Rufolo, *The Regulation of Immobile Housing Assets Under Divided Ownership*, 19 Int'l Rev. L. & Econ. 383, 396 (1999). Again in 2002, an empirical study by a University of California economist showed that in one upscale California community, tenant-legislators were able to pocket almost $61,000 per coach in confiscated asset value as a direct result of enacting mobile home park rent control. *See* John M. Quigley, *Economic Analysis of Mobile Home Rent Control: The Example of San Rafael, California* (Sept. 12, 2002). The most recent scholarly research on this topic was conducted by economists at the prestigious Lusk Center for Real Estate at the University of Southern California. Like Hirsch, Hirsch & Rufolo, and Quigley, these researchers confirmed that mobile home park rent control is a powerful and effective mechanism for confiscating the value of park land and transferring it to tenants who then convert it to cash. *See* David Dale-Johnson, Yongheng Deng, Peter Gordon & Diehang Zheng, *An Examination of the Impact of Rent Control on Mobile Home Prices in California*, Working Paper No. 2004-1010, Lusk Center for Real Estate, University of Southern California (Nov. 1, 2004).

This confiscation by tenants of the value of park owners' land was initially challenged as a taking under the "permanent physical occupation" theory of *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). The Ninth Circuit agreed with this analysis, striking down a mobile home rent control scheme in *Hall v. City of Santa Barbara*, 833 F.2d 1270. Significantly, the court of appeals went beyond the physical taking issue presented by the plaintiffs, to consider

whether Santa Barbara's ordinance could be said to substantially advance legitimate state interests—and found that it could not. *See id.* at 1280. Because new tenants would receive no financial benefit from rent control, having paid its full cash value to the previous coach owners, the *Hall* court found that the law "may well hinder" its objective of alleviating a "critical shortage of low and moderate income housing." *Id.* at 1280-81.

The successful *Hall* litigation triggered a number of lawsuits challenging the constitutionality of mobile home rent control in California. In 1992, one such action, *Yee v. City of Escondido*, 503 U.S. 519, was accepted for review by this Court. Justice O'Connor's majority opinion focused on the legal-theoretical shortcomings of applying the *Loretto* physical takings model to rent control. The Court recognized and addressed the effect of Escondido's ordinance in enabling tenant-legislators to capture the monetary value of the regulations in the resale price of their coaches. *See id.* at 530. Yet, while acknowledging that such an explicit majoritarian wealth transfer might fall "within the scope of our regulatory taking cases," *id.* at 527, the Court rejected the park owners' argument that the tenants' capture of the value of occupying the plaintiffs' property effected a physical taking. Perhaps most significantly, Justice O'Connor went on to add:

> This effect might have some bearing on whether the ordinance causes a ***regulatory*** taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance.

Id. at 530 (citing *Nollan*, 483 U.S. at 834-35). This is, of course, a reference to the substantial advancement takings standard, already cited by the Ninth Circuit as an alternative basis for takings liability in *Hall*. Yet despite the urging of Judge Bork's brief for the petitioners and an amicus brief filed

in their support by Pacific Legal Foundation, the Court declined to consider the merits of a regulatory takings claim in *Yee*, on the technical grounds that this question had not been presented in the Yees' petition for certiorari. *See id.* at 533.

The first response to *Yee*'s seeming invitation came in *Richardson v. City and County of Honolulu*, 124 F.3d 1150 (9th Cir. 1997). Typically, there is divided ownership of condominiums on Oahu and the underlying land. The ordinance at issue in *Richardson* limited land-rent increases and specifically provided that the below-market rents were transferable, thereby facilitating capture and capitalization of the financial benefits of rent control by condominium residents. As in the analogous case of mobile home parks, the Ninth Circuit recognized that "[i]ncumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium." *Id.* at 1166. Drawing on *Yee*, the court of appeals went on to note that this feature of the ordinance prevented it from substantially advancing legitimate governmental interests:

> The conveyance provision, as explained above [facilitating the capitalization and capture of the monetary benefits of rent control], vitiates the cause-and-effect relationship between the property use restricted (rent rates) and the social evil the Ordinance seeks to remedy (lack of affordable housing).

Id. at 1165.

A similar analysis was subsequently applied in *Chevron U.S.A. Inc. v. Cayetano*, 224 F.3d 1030 (9th Cir. 2000), the immediate forerunner of the present case before the Court. However, the Ninth Circuit found that summary judgment had been improperly granted because of the existence of conflicting expert testimony on whether the premium created by the regulations could be capitalized and captured by the dealers, or

whether Chevron could offset this effect by adjusting the wholesale price of its gasoline. At this point the factual dispute in *Chevron* diverges from the mobile home park paradigm, since in the latter case there is no possibility of a secondary, offsetting revenue flow between owners and tenants.

Meanwhile, independently of the *Chevron* litigation, a *Richardson*-based regulatory takings challenge to a mobile home park rent control scheme came before the Ninth Circuit. In 1998, the voters of the City of Cotati terminated years of litigation by repealing that city's general rent control ordinance. But no sooner had the electorate voted to remove rent control from the books, than the city council adopted a new measure that applied rent control exclusively to mobile home parks. The city's three park owners, including the present amici Gene Cashman and Athena Sutsos, filed suit under a *Richardson*-style substantial advancement takings theory. This case, *Cashman v. City of Cotati*, 374 F.3d 887, reached the Ninth Circuit in 2004.

In a decision that closely tracks the legal analysis of *Richardson*, the *Cashman* panel reversed a trial court's ruling that Cotati's new rent ordinance passed constitutional muster, and held that an earlier order granting summary judgment to the park owners should be reinstated. The panel noted the case's factual similarity to *Richardson*, which was also decided on summary judgment:

> Like in *Richardson*, there is no dispute that Ordinance No. 680 does not on its face prevent mobilehome tenants from capturing a premium. There is separate ownership of the mobilehome coaches and the underlying land, controlled rent, and the ability of incumbent tenants to sell their mobilehomes subject to this controlled rent. This creates the possibility of

> a premium, which undermines the City's interest in creating or maintaining affordable housing.

Cashman v. City of Cotati, 374 F.3d 887, 899 (2004).

Moreover, the *Cashman* court pointed to the absence of extraneous variables such as were present in *Chevron*, that could potentially prevent Cotati's tenants from capitalizing and capturing the rent control premium.

On August 3, 2004, the City of Cotati filed a petition with the Ninth Circuit seeking rehearing or rehearing en banc, once again urging rejection of the substantial advancement standard and heightened scrutiny of regulatory takings claims. This petition remains pending, presumably awaiting this Court's determination of the present case.

It is essential that this Court maintain the vitality of the substantial advancement test if there is to be any justice for victims of majoritarian rent-seeking such as Gene Cashman and Athena Sutsos. Under a deferential due process standard, the constitutional rights of Cashman, Sutsos, and hundreds of other mobile home park owners in California will be worth no more than those of the plaintiffs in *Mayhew*.

IV

THE CORRECT APPLICATION OF THE SUBSTANTIAL ADVANCEMENT STANDARD IS A STRAIGHTFORWARD EXERCISE OF THE LEGITIMATE FUNCTION OF JUDICIAL REVIEW

The radical position advanced by the State and the Solicitor General in this case comprises a protest against this Court's fundamental approach to regulatory takings analysis—and indeed, against the very concept of regulatory takings. The argument to relegate *Agins*' first prong to a due process inquiry may seem more plausible, because it appears to be more

limited, than calls for overruling *Penn Central* and *Pennsylvania Coal*, or for the outright elimination of regulatory takings as a viable constitutional claim. Nevertheless, since the substantial advancement test or its conceptual equivalent has been an essential element of this Court's takings jurisprudence since its inception, appeals to eliminate this standard fit easily within the broader assault on regulatory takings per se. The underlying theme is that courts should not apply the Takings Clause in any situation not involving outright physical appropriations:

> What is wrong with a simple reading of the Takings Clause that would apply it to occasions when the government actually physically takes and uses the land in question? What limitations could there then be on the government's overreaching by regulation? What should a court do when the government goes too far? If "goes too far" means the same thing as interfering with due process rights in property, then the more consistent, predictable, and traditional result would be to strike down the regulation as an unconstitutional denial of due process.

Kenneth Salzberg, *Rights with Responsibilities Land Use Law Symposium: "Takings" as Due Process, or Due Process as "Takings"?*, 36 Val. U. L. Rev. 413, 418 (2002).

Of course, what's "wrong" with eliminating the doctrine of regulatory takings was spelled out by Justice Brennan in his dissent in *San Diego Gas & Electric Co. v. City of San Diego*, 450 U.S. 621 (1981), the first opinion to employ the term, "regulatory taking." In that case, the California Supreme Court adopted the rule proposed by the passage above: a land-use regulation can *never* violate the Takings Clause, but at worst may be invalidated as a violation of due process. *See id.* at 621. As Justice Brennan pointed out, invalidation is hardly an adequate remedy for a plaintiff who (in that case) was deprived

of the use of its property for seven years. At least equally important, the unavailability of a regulatory taking claim encourages government agencies to promptly adopt new regulations whenever one is struck down on due process grounds, to maintain oppressive and unconstitutional restrictions indefinitely. Justice Brennan brought this point home by quoting extensively, in his *San Diego Gas* dissent, from a tract circulated by a California city attorney, light-heartedly urging his colleagues to do just that. *See id.* at 655-57.

A few of the staunchest regulatory partisans have directly repudiated Justice Brennan's reasoning, insisting that compensation under the Takings Clause should *never* be required for land-use regulations, no matter how draconian or basely motivated. *See, e.g.*, Norman Williams, et al., *The White River Junction Manifesto*, 9 Vt. L. Rev. 193, 193-97 (1984). More commonly, however, as in the case at bar, the imposition of regulatory takings liability is rejected on more abstract grounds: close judicial review of legislative or administrative actions is said to undermine the separation of powers, threaten the principle of democratic self-government, be contrary to the plain language of the Drafters, or signal a return to "Lochnerism." *See, e.g.*, Pet. Brf. at 39; Brf. for United States at 12-13. At this level of generality, however, these arguments run aground on the commonplace observation that the Constitution was *intended* to check majoritarian excesses, and interpreting the document's proper application to the other two branches of government has been an essential attribute of the judiciary since *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803). *See also* Alexander M. Bickel, *The Least Dangerous Branch*, 1-14 (2d ed. 1986) (critiquing the argument for judicial review flowing from *Marbury*). As for the bogey of *Lochner*, no supra-textual normative charter is required for courts to administer the straightforward protections of property owners that animate the Fifth and Fourteenth Amendments. The proper

role of a court applying the substantial advancement test to takings claims has seldom been expressed more clearly than by Chief Judge Loren Smith of the Court of Federal Claims:

> In takings claims the judge does not sit as super legislator or executive, intent on preventing regulation that "goes too far," as a facile reading of Justice Holmes might imply. The job of the court is to deal with a concrete claim, by an aggrieved person or persons, that their Constitutional rights under the Fifth Amendment have been violated by some governmental action. The court must proceed to analyze this claim, as any other legal claim, regardless of the consequences to government policy.

Hage v. United States, 35 Fed. Cl. 147, 150-51 (1996).

In the final analysis, courts engaged in the proper application of the substantial advancement test are doing no more than performing their responsibility under our constitutional system of checks and balances. As the majority of this Court's Justices noted in *Eastern Enterprise*, the first requisite for the application of this standard is the existence of a discrete, constitutionally protected property interest. Once that threshold is met, the test resolves to a two-part inquiry: (1) Is the regulation designed to mitigate some public harm *that would otherwise be caused* by the unregulated use of the property in question? (2) Does the regulatory scheme single out some small group of property owners to bear a burden that should, in fairness and justice, be borne by the public as a whole? *See Armstrong v. United States*, 346 U.S. 40, 49 (1960). If the answer to the first inquiry is negative, or if the answer to the second inquiry is affirmative, the regulatory scheme in question fails to substantially advance legitimate state interests "***within the meaning of our regulatory takings doctrine***," *City of Monterey*, 526 U.S. at 721 (emphasis added), and thereby violates the Takings Clause.

CONCLUSION

For all the reasons set forth above, the opinion of the court below should be AFFIRMED.

DATED: December, 2004.

Respectfully submitted,

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IN THE
Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,
Petitioners,

v.

CHEVRON USA, INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR THE SERVICE STATION DEALERS OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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INTERESTS OF AMICUS CURIAE[1]

The Service Station Dealers of America ("SSDA") is a national nonprofit trade association which represents the interests of independent service station dealers located throughout the United States. SSDA was formed in 1948, and represents 20 state and regional affiliates, which in turn represent over 15,000 independent dealers in over 25 states. These independent dealers have a vital interest in supporting legislation such as Act 257, Haw. Rev. Stat. § 486 H-10.4 (1997), which is intended to provide long-term benefits to the citizens of Hawaii by ensuring that the State's retail market is preserved from the oligopoly that has already seized control of the State's wholesale market for gasoline.

REASONS FOR REVERSING LOWER COURT RULING

The constitutional arguments for reversing the lower courts' ruling have been fully laid out in Appellant's brief and will not be repeated here. SSDA will address only the lower courts' assumptions that there is no reason to believe that oil companies would attempt constructive eviction by charging high rents to their lessee-dealers and that, in any event, the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. §§ 2801-2806, "already prevents an oil company from raising rents for the purpose of driving dealers out of business and converting the premises to company-operated stations." *Chevron U.S.A., Inc. v. Cayetano,* 198 F. Supp.2d 1182, 1193 (D.Haw. 2002). *See also Chevron USA, Inc. v.*

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[1] In compliance with Rule 37.6 of this Court, amicus curiae, the Service Station Dealers of America, states that no counsel for any party authored this brief in whole or in part, and that no party or entity other than this amicus curiae, its members or its counsel made a monetary contribution to the preparation or submission of this brief.

Bronster, 363 F.3d 846, 856 (9th Cir. 2004). SSDA submits that these assumptions are insupportable.

Major oil companies like Chevron enjoy enormous leverage over lessee-dealers such as those in Hawaii because they are the dealers' landlords, licensors and exclusive suppliers. This provides them with the ability to destroy their dealers' economic viability. The Senate Report accompanying the passage of the PMPA expressed concern with this problem of supplier dominance that is peculiar to the petroleum industry:

> The franchise relationship in the petroleum industry is unusual, in fact perhaps unique, in that the franchisor commonly not only grants a trademark license but also controls, and leases to the franchisee, the real estate premises used by the franchisee. In addition the franchisor almost always is the primary, even exclusive, supplier of the franchisee's principal sale item: motor fuel.

S.Rep. No. 731, 95th Cong., 2nd Sess., 17 (1978).

Typically, lessee-dealers sink significant expenditures into their businesses based upon the reasonable assumption that their franchise and lease relationships will not be arbitrarily terminated or non-renewed. Their "reasonable expectations" in that regard were also noted in the PMPA Senate Report:

> It is also important to note that often the reasonable expectations of the parties to a motor fuel franchise are that the relationship will be a continuing one. This expectation by the franchisee, in particular, is often the

> result of, and fostered by, statements and actions of the franchisor. As a result, non-renewal of a motor fuel franchise relationship at the expiration of its term can be almost as punitive as termination of the franchise during its term. The reasonable expectations of the franchisee, rather than any definitive contract rights, are destroyed.

Id. at 18.

The district court recognized the crucial role independent service station dealers play in maintaining interbrand and intrabrand competition in what otherwise would be an oligopolistic market, such as Hawaii. It found that "[f]ewer lessee-dealer stations in the market means that retail prices will increase." 198 F. Supp.2d at 1192. The district court explained:

> In the first place, fewer lessee-dealers means greater concentration at the retail level, which means less intra-brand and interbrand competition. In the second place, the fewer lessee-dealers there are, the easier it is for wholesale gasoline suppliers to engage in cooperative pricing, leading ultimately to higher wholesale and retail prices.

Id. This significant finding of fact was not challenged by the court of appeals.

The State of Hawaii has a legitimate interest in preserving what competition remains in an increasingly oligopolistic marketplace. If the lower courts' assumptions that oil companies will not attempt to use high rents to eliminate independent lessee-dealers and that, in any event,

the dealers are protected from constructive eviction by the PMPA are unfounded, then the legislature had a reasonable basis for protecting independent dealers from constructive eviction as a means of preventing the upward impact on retail prices that the district court found would otherwise occur as the result of diminished intrabrand and interbrand competition.

SSDA believes itself qualified to comment upon the lower courts' assumptions based upon its extensive knowledge of nationwide conditions in the retail gasoline market. In fact, what has been occurring throughout the retail gasoline market over the past twenty years, coupled with the failure of the PMPA effectively to address the issue of constructive eviction, directly contradicts these assumptions.

That major oil companies have, in fact, too often targeted their own dealers for extinction has been recognized by congressional report. Senate Report No. 102-450 (1992) warned of the oil companies' abuse of their pricing power to evict lessee-dealers in order to convert their stations to company-operation. The report observed:

> Oil companies need not engage in an overt "retail below wholesale" inversion in order to drive their dealers and distributors out of business. Instead, they simply raise the dealers' costs through increased rent, credit card charges, forced 24-hour operation, and the imposition of other costs of doing business that render the superior marketing efficiency of independent dealers and distributors meaningless.

Id. at 5.

Describing the intentions of one major oil company to decimate its own dealers, as detailed in its own Strategic Planning Unit document, the Senate Report recounted ARCO's plans for the future of its "dealer apparatus":

> The "dealer apparatus" would have their costs raised by the implementation of "economic rents" which would raise rents by a factor of 300 to 400 percent. This increase would have two primary effects -- it would make the company indifferent, to a degree, to the sales of motor fuel by the dealers, and it would result in hundreds of dealers being forced out and replaced by company-operated stations. ARCO then planned to "keep prices low until the politic resistance fades," and after that time, a "period of lasting accepting profitability would occur."

Id. at 6. Summarizing the unhealthy market trend that it perceived, the Senate Report concluded, "Any market in which the most efficient marketers are being driven out of business is not a healthy, competitive market." *Id.* at 4.

Two recent federal decisions found that Exxon had abused its pricing power methodically to drive its own lessee-dealers out of business. In *Mathis v. Exxon Corp.*, 302 F.3d 448, 459 (5th Cir. 2002), the Fifth Circuit found that Exxon's Houston and Corpus Christi, Texas dealers had presented "ample evidence" to document Exxon's use of its pricing power to replace independent dealers with company-operations in Houston, and with jobber-supplied locations in Corpus Christi. The court said:

> Although Exxon decided to move to CORS [company-operated locations] in Houston and jobbers in Corpus Christi, this decision was not communicated to its franchisees. Because of profits from their other sales, CORS could, and did, sell gas for less than the franchise dealers paid to Exxon for their gas. And the jobbers delivered Exxon gas to their dealers for less than Exxon franchisees were required to pay for their delivered gas, but Exxon prohibited its franchisees from buying at this lower price from the jobbers.
>
> The loss of competitive position and profit to plaintiff franchisees was inevitable and foreseeable to Exxon. Although Exxon witnesses denied receiving complaints, its dealers testified that they had complained often and for years, without success, until the very eve of trial.

Id.

In *Allapattah Services, Inc. v. Exxon Corp.*, 61 F. Supp.2d 1308, 1313 (S.D. Fla. 1999), *aff'd*, 333 F.3d 1248 (11th Cir. 2003), the district court denied Exxon's motion for summary judgment directed against a claim asserted by a nationwide class of Exxon lessee-dealers that Exxon had evicted numerous of its dealers "by secretly dividing its dealers into 'keepers' and 'non-keepers,' while internally recognizing that its pricing practices were driving the 'non-keepers' out of business." Ultimately, the jury found for the dealer class after reviewing Exxon's own internal documentation, which confirmed its intent to price many of its own dealers out of business.

Significantly, in *Mathis* and *Allapattah* Exxon's design to destroy its own lessee-dealers was *not* challenged under the PMPA but under Uniform Commercial Code § 2-305, which subjects the sale of goods pursuant to open-price-term contracts (such as dealer supplier agreements) to a standard of commercial reasonableness. That provision is not applicable, however, to excessive rent demands made by oil companies on a non-negotiable basis at the time of lease renewal, with the intent and/or effect of making it impossible for the lessee-dealer to continue to operate his or her station.

Recent decisions, unfortunately, have weakened the ability of independent dealers even to utilize U.C.C. § 2-305 as a defense to their suppliers' efforts to convert their stations to company-operation. Rejecting the Fifth Circuit's prediction in *Mathis* concerning its interpretation of state law, the Supreme Court of Texas held in *Shell Oil Co. v. HRN, Inc.*, 144 S.W.3d 429, 435 (Tex. 2004), that an oil company's subjective intent to drive its dealers out of business and convert their locations to company operation is irrelevant for purposes of U.C.C. § 2-305, so long as its prices remain in the range of prices charged by other refiners in the marketplace. In increasingly oligopolistic markets, like Hawaii, this restrictive interpretation of §2-305 affords the dealer little if any protection against abusive pricing schemes intended to convert his or her station to company operation.

It is no accident that PMPA challenges ultimately were not pursued in *Mathis* or *Allapattah*. Contrary to the assumptions made by the courts below, the PMPA has proven wholly ineffective in protecting independent dealers targeted for extinction through non-competitive pricing or through non-negotiable high rent demands made at the time of lease renewal. This is so because the pertinent statutory provision, 15 U.S.C. § 2802(b)(3)(A), only grants relief to a

dealer who can prove that his or her supplier's renewal terms were consciously formulated so as to frustrate the continuation of the franchise relationship. As a result, so long as the oil company is not stupid enough to concede the true purpose of its pricing or rent demands, the dealer is very unlikely to secure relief under the PMPA. *See, e.g., Duff v. Marathon Petroleum Co.*, 863 F. Supp. 622, 628 (N.D. Ill. 1994), *aff'd*, 51 F.3d 741 (7th Cir. 1995) ("Under the PMPA, Marathon does not need to prove that the rent increases were reasonable, only that they were made in the ordinary course of business and not as a pretext for termination of the franchise."); *Ackley v. Gulf Oil Corp.*, 726 F. Supp. 353, 368 (D. Conn.), *aff'd*, 889 F.2d 1280 (2d Cir. 1989) (rent increases of up to 761% not challengeable because it is not sufficient that rent formula "operate unreasonably in a particular case"); *Brown v. Magness Co.*, 617 F. Supp. 571, 575 (S.D. Tex. 1985) ("The fact that new provisions in a franchise agreement may make the station unprofitable for the lessee is not of itself determinative of an improper purpose, nor does the fact that the new terms are presented on a take-it-or-leave-it basis constitute lack of good faith.") (internal citations omitted); *Meyer v. Amerada Hess Corp.*, 541 F. Supp. 321, 330 (D. N.J. 1982) (upholding rental increase of over 300%).

Loading the dice further against dealers seeking to challenge exorbitant rent demands presented to them on a non-negotiable basis by their oil company landlords, two circuits have recently held that dealers cannot sign leases "under protest" and commence PMPA litigation, but must risk non-rescindable notice of termination in order to mount a court challenge. *Abrams Shell v. Shell Oil Co.*, 343 F.3d 482 (5th Cir. 2003); *Dersch Energies, Inc. v. Shell Oil Co.*, 314 F.3d 846 (7th Cir. 2002). This means that if the dealer is unable to unmask the oil company's hidden intent, he or she is out of business.

Further undermining the willingness or ability of independent dealers to mount a PMPA challenge is the virtually universal practice of oil companies of inserting in their form franchise agreements prevailing party attorneys-fees provisions or one-sided provisions requiring the dealer to pay the oil company's attorneys fees if his or her challenge is unsuccessful. To the dealer alone such attorneys fees are ruinous.

The net result of all this is that, in the real world, attempts by independent dealers to use the PMPA to challenge their suppliers' unreasonable take-it-or-leave-it rent proposals are rarely even attempted much less successful, which is totally inconsistent with the lower court's erroneous assumption that the PMPA "prevents an oil company from raising rent for the purpose of driving dealers out of business and converting the premises to company-operated stations." *Chevron U.S.A,,* 198 F. Supp.2d at 1193. In the real world, that simply is not so.

Unfortunately, SSDA lacks the resources and ability to document the extent through which the ranks of independent dealers have been thinned by the oil companies' exorbitant non-negotiable rent demands and predatory pricing policies. Based upon its observation of the industry, however, SSDA submits that the impact has been very substantial. Typical of the extensive anecdotal evidence that it has received is the recent report from its New England affiliate:

> Shell has raised rent so much in Massachusetts and New Hampshire that the dealer population has been reduced by about 40% in the past three years. There is only one dealer left on Cape Cod, a few years ago

> there were dozens. Dealers exhausted their working capital, then resorted to loans and equity loans. Most eventually lost their businesses, some had buyers, but still went bankrupt because of the lengthy, cumbersome, subjective approval process [required by Shell to obtain its consent to assignment].
>
> Exxon is similar, many dealers got fed up and turned in the keys. All along intending to sell the business as a substantial part of their retirement savings.

Given the PMPA's failure to address effectively the issues of constructive termination and economic non-renewal, a number of states have implemented measures to protect independent service station dealers from extinction. Most notable are restrictions on refiner-operated service stations. By restricting the ability of major oil companies to operate service stations themselves, such laws eliminate the oil companies' motive for driving independent dealers out of business through high rent demands or other pricing schemes. At least five jurisdictions impose such restrictions on refiners' ability to convert independent service stations to company operation. *See* CONN. GEN. STAT. ANN. § 14-344a (West 2004); DEL. CODE ANN. tit. 6, § 2905 (2004); D.C. ST. § 36-302.02 (West 2001); MD. CODE ANN., BUS. REG. § 10-311 (2004); VA. CODE ANN. § 59.1-21.16:2 (West 2004). In addition, Nevada requires any refiner operating more than thirty service stations in the state to lease one station to an independent dealer for every two directly owned service stations. *See* NEV. REV. STAT. ANN. § 597.440 (West 2004).

Other states, such as Alabama, Missouri, Florida, Utah and North Carolina, have passed legislation restricting

oil companies from competing unfairly with independent dealers through company-operated stations. *See* ALA. CODE § 8-22-1 *et seq.* (2004); MO. ANN. STAT. § 416.615 (West 2004); FLA. STAT. ANN. § 526.304 (West 2004); UTAH CODE ANN. § 13-16-4 (2001); N.C. GEN. STAT. § 75-82 (2004). These statutes attempt to restrict the oil companies from pricing their dealers out of business by unfairly favoring their company-operated locations.

Any doubt about these states' ability to enact legislation intended to promote competition in the petroleum market to the ultimate benefit of the motoring public should have been laid to rest by this Court's opinion in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978). In upholding the constitutionality of the Maryland divorcement statute, which precluded oil companies from displacing independent dealers with company-operated stations, this Court stated:

> The evidence presented by the refiners may cast some doubt on the wisdom of the statute, but it is, by now, absolutely clear that the Due Process Clause does not empower the judiciary "to sit as a 'super legislature to weigh the wisdom of legislation' . . ." *Ferguson v. Skrupa*, 372 U.S. 726, 731 (citation omitted) . . . . Regardless of the ultimate economic efficacy of the statute, we have no hesitancy in concluding that it bears a reasonable relation to the State's legitimate purpose in controlling the gasoline retail market, and we therefore reject appellants' due process claim.

Id. at 124-25.

Simultaneous with the enactment of Act 257 at issue here, Hawaii repealed Hawaii Rev. Stat. § 486 H-10, a divorcement statute that was analogous to the Maryland provision upheld by this Court in *Exxon*. Hence, the present statute represents no more than an alternative method of addressing the problem previously addressed by the divorcement statute. Indeed, Act 257 is less burdensome than its predecessor because it frees major oil companies to operate competing company-operated locations. Far from a renegade measure, the new statute represents a compromise, allowing oil companies to operate service stations while simultaneously protecting independent dealers from outrageous rent demands. In *Exxon's* language, "[r]egardless of the ultimate economic efficacy of the statute,. . .it bears a reasonable relation to the State's legitimate purpose in controlling the gasoline retail market. . . ." *Id.* at 125.

SSDA respectfully submits that due deference should be shown to Hawaii's determination that independent dealers should be preserved from extinction in order to promote interbrand and intrabrand competition in the retail gasoline market. This is particularly so because the lower court's assumptions that oil companies will not use high rents to eliminate lessee-dealers and that those dealers are adequately protected by the PMPA are debatable at best; and, the district court itself recognized the substantial linkage between preserving interbrand and intrabrand competition at the retail level and protecting Hawaii's citizens against the threat of oligopolistic price gouging. *Chevron U.S.A.*, 198 F.Supp.2d at 1193. SSDA respectfully submits, therefore, that the lower courts' invasion of Hawaii's legislative province should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF HAWAII, ET AL.,
Petitioners,

v.

CHEVRON U.S.A. INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* SMALL PROPERTY OWNERS OF SAN FRANCISCO INSTITUTE, SAN FRANCISCO APARTMENT ASSOCIATION, CALIFORNIA APARTMENT ASSOCIATION and SAN FRANCISCO ASSOCIATION OF REALTORS IN SUPPORT OF RESPONDENT, CHEVRON U.S.A. INC.

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STATEMENT OF INTEREST

Small Property Owners of San Francisco Institute, San Francisco Apartment Association, California Apartment Association and San Francisco Association of Realtors submit this amici curiae brief supporting Chevron USA, Inc.[1]

The Small Property Owners of San Francisco Institute is a non-profit organization dedicated to the fair treatment of small property owners in San Francisco. The Institute was recently founded to expand upon the efforts of Small Property Owners of San Francisco ("SPOSF"), whose members typically own buildings with two to six apartments. SPOSF together with SFAA and SFAR recently has defeated a local ordinance prohibiting property owners from living in their own properties. *Tom v. San Francisco*, 120 Cal.App.4th 674 (2004). SPOSF has also filed amicus briefs in the California courts. E.g., *Drouet v. Superior Court*, 31 Cal.4th 583 (2003). Most recently, the Institute joined the Washington Legal Foundation in filing an amicus brief in *San Remo Hotel v. San Francisco*, No. 04-340. The Institute also conducts education, outreach, and research programs designed to help small property owners understand and protect their rights, and works to help San Francisco's residents understand the societal costs of restrictive regulations and rent control.

The San Francisco Apartment Association ("SFAA") has been a non-profit trade association since 1917. SFAA's 2,700 members own small to medium-sized apartment buildings in

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[1] The parties have filed letters consenting to the filing of this amici curiae brief. No counsel for any of the parties authored any part of this brief. No person or entity other than the amici filing this brief has made any monetary contribution to the preparation or submission of this brief.

San Francisco with more than 60,000 rental units. SFAA defends its members by challenging unfair local government regulations, has prosecuted several actions, e.g., *Tom v. San Francisco*, 120 Cal.App. 4th 674 (2004)(successful challenge to ordinance prohibiting owner occupancy of property), and has filed amicus briefs in the California courts. SFAA also advises its members concerning the extraordinarily complex and growing regulations imposed by the City and County of San Francisco.

The California Apartment Association ("CAA") is the largest statewide rental-housing trade association in the United States, with a diverse membership of 50,000 rental property owners and managers ranging from California's largest property management companies to individuals with a single rental unit, which control nearly two million rental units in California. CAA provides a voice for rental property providers throughout California, and encourages the fair, ethical, and professional operation of rental housing.

The San Francisco Association of Realtors ("SFAR") (formerly the San Francisco Real Estate Board) was founded as a non-profit association on February 6, 1905. It antedates the National Association of Realtors and the California Association of Realtors. It actively participated in the formation of both of these organizations. SFAR presently represents more than 4,200 members, most of whom are active residential real estate brokers and agents. It is dedicated to providing service to its members, the community, and the public at large. SFAR was founded upon the principle that the wise utilization of real property is fundamental to the growth and survival of this country. To that end, it promotes policies that lead to the highest and best use of land, the safeguarding of property rights, equal opportunity in housing, and professional competence. SFAR actively lobbies local

government in this regard and when necessary and appropriate it properly challenges local ordinances. It joined with SFAA and SPOSF in *Tom v. San Francisco*, 120 Cal.App.4th 674 (2004). It took the lead in *Cwynar v. San Francisco*, 90 Cal.App.4th 637 (2001), a takings challenge to a local ordinance that limited the occupancy rights of owners of residential real property. SFAR joins in filing this amicus brief to advance the interest in fair judicial scrutiny under the United States Constitution of local laws and regulations that so diminish the bundle of sticks that is ownership as to effect a taking.

SUMMARY OF ARGUMENT

Amici file this brief because the constitutional issues raised by this case are poorly presented by a fight waged by a multi-national corporation with billions of dollars and a state with millions of taxpayers. Unlike the property owners who will be most affected by the decision in this case, Chevron can afford to protect itself by using its resources to influence the political process.

The consequences of the constitutional issue are best illustrated by the millions of property owners who are targeted by cities and states to pay the costs of public goods that should be borne by the public as a whole. The vast majority of those property owners cannot protect themselves in the political process and are, accordingly, targeted by cities and states to pay for problems that they did not cause and did not exacerbate. It is all too easy for legislators to exact funds from the few, rather than explain tax increases to the voters. And, with enormous budget deficits, state and local governments are increasingly reaching for easy options.

The appeal of such easy options was predicted by Justice Oliver Wendell Holmes more than 70 years ago, when this Court held that the police power to regulate property must be limited by the courts under the Fifth Amendment:

> If instead, the uses of private property were subject to unbridled, uncompensated qualification under the police power, "the natural tendency of human nature [would be] to extend the qualification more and more until at last private property disappear[ed]".

Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1014 (1992), quoting *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

Hawaii seeks to preserve and protect those easy options, and asks this Court to reverse its prior decisions in order to give state and local governments that luxury. In Hawaii's view, any meaningful judicial review of its legislation under the decades-old substantial advancement test would amount to a return to the *Lochner* era. Hawaii raises the specter that judicial review of legislation that imposes public costs on a few private property owners will transform the courts into an unelected, super-legislature.

That argument is wrong. No decision of the courts under the Takings Clause could ever prohibit Hawaii's legislature from acting in its own perception of the public good. The Takings Clause requires only that Hawaii's taxpayers pay the costs of regulations that go too far. Indeed, that is the only question in this case, and the lower courts properly held that Hawaii may not single out two property owners to pay the entire cost of this attempted solution to a public problem. The cost should be borne by the public as a whole.

In short, this is an unusual case that presents the usual problems. Here, Hawaii has chosen to regulate Chevron's property, requiring Chevron to subsidize its gasoline station operators. Hawaii's stated purpose was to reduce the price of gasoline to the consumer for the public good. But, the law's failure to advance that purpose demonstrates that Hawaii's real (if unstated) purpose was to provide a subsidy for local gasoline station operators at Chevron's expense, and that is a cost that the public should bear.

The State argues, however, that the courts may not even evaluate the legislation under the substantial advancement test. The State claims that if the courts ask whether a legislative decision to subsidize gasoline station operators at the expense of two property owners substantially advances a legitimate government purpose, the legislative heavens will fall. And, Hawaii stretches the argument even further. As Hawaii would strike the "balance" between legislators and the courts, the courts must give legislators free rein to reduce their burgeoning deficits and appease their taxpayers by imposing the costs of public programs on small groups of property owners.

This Court has long disagreed. The issues raised by Hawaii have long been foreclosed by decisions of this Court establishing the substantial advancement test. Nothing new is offered by Hawaii. Contrary to Hawaii's claims, this Court's substantial advancement decisions have not transformed the courts into super-legislatures. Indeed, the substantial advancement test makes the courts precisely what they should be: guardians of the Constitution.

In this case, the lower courts merely required, as the Takings Clause demands, that Hawaii not impose the cost of this regulation on Chevron. If this law is invalidated because

the State chooses not to pay that cost, that does not mean that the courts have imposed their own economic policies. The State is free, and remains free, to adopt economic regulations that its legislators believe will create a public benefit, as long as they do not impose the cost of those decisions on a few property owners, rather than Hawaii's taxpayers as a whole.

In sum, while Chevron may not be the most sympathetic beneficiary of the Fifth Amendment, this case hardly provides a reason to revisit this Court's decisions under the Takings Clause. When the courts protect the few -- even the richest of the few -- they send a message that legislators must follow the Constitution. The lower courts followed this Court's decisions and those decisions were right.

ARGUMENT

I. THE STATE OF HAWAII PRESENTS NO REASON FOR THIS COURT TO OVERRULE ITS DECISIONS UNDER THE SUBSTANTIAL ADVANCEMENT TEST

In *Agins v. Tiburon*, 447 U.S. 255, 260 (1980), this Court held that an economic regulation violates the Takings Clause of the Fifth Amendment if it fails to substantially advance a legitimate government interest. This Court has repeatedly reaffirmed that holding. E.g., *Lucas*, 505 U.S. at 1016.

This Court has also expressly rejected the very argument that Hawaii makes here -- that Takings Clause claims should be reviewed under the same test as claims under the Due Process Clause. Petitioners' Brief on the Merits ("Pet. Mer. Br.") at 14-36; *Nollan v. California Coastal Commission*, 483 U.S. 825, 834 n. 3 (1987) (takings tests are not "the same as those applied to due process and equal protection claims");

Dolan v. Tigard, 512 U.S. 374, 391 (1994) (reasonable relationship test does not apply under Takings Clause because it "seems confusingly similar to the term 'rational basis' which describes the minimal level of scrutiny under the Equal Protection Clause").

Understandably, the State does not even address the standards set out by this Court for overturning its own decisions. E.g., *State Oil v. Kahn*, 522 U.S. 3, 20 (1997) ("We approach the reconsideration of decisions of this Court with the utmost caution."). Instead, the State offers its fear that this Court's Takings Clause decisions will result in a judicial revival of *Lochner v. New York*, 198 U.S. 45 (1905).

Hawaii's arguments have been made and rejected before, and this legislation giving subsidies to its gasoline station operators for the "public good" adds nothing to the debate. As an obvious point, this Court was fully aware of *Lochner*-era jurisprudence when it decided *Agins*, and when it repeatedly reaffirmed the underlying doctrinal grounds for *Agins*' holding. E.g., *Lucas*, 505 U.S. at 1016. The Takings Clause addresses dangers of governmental leveraging that the Due Process Clause does not address. *Nollan*, 483 U.S. at 834-837. The substantial advancement test under the Takings Clause is required to prevent legislators from using regulations to force a few property owners to bear the general costs of remedying societal problems. That potential for mischief cannot be prevented by the political process alone because it will always be politically popular to impose the costs of the many on the few.

The last 25 years have shown that, with the substantial advancement test, this Court struck the appropriate balance between protecting property rights and allowing sufficient latitude for governmental regulation of property. Since *Agins*,

there has been no flood of substantial advancement litigation, let alone a flood of judgments for plaintiffs. Indeed, the substantial advancement test is sufficiently difficult to meet that it takes a regulation as extreme as rent control for gasoline stations to satisfy the test.

Even in the few cases in which regulations have gone too far, the substantial advancement test presents no serious conflict between the courts and legislators. A decision under the Takings Clause does not require the courts to invalidate legislation as in *Lochner*. It requires only that the costs of the legislation be borne by taxpayers, rather than by property owners who are singled out because they can be forced to pay. Even when a court rules that legislation is a taking, its ruling will not prevent any legislature from acting in the name of the public good. The legislature may proceed as long as it pays the cost of its legislation.

Hawaii's predictions of legislative ruin caused by this case are unwarranted. An affirmance in this case will not ruin any legislature, but may ruin the careers of individual legislators who are willing to disregard their constitutional oaths. In virtually every city and state, legislators will not be reelected if their constituents are required to pay for all that they were promised. For those legislators, the "solution" is increasingly to force the few to pay for the many, whether by constitutionally permissible means or not. Here, the lower courts followed this Court's decisions and rejected that "solution."

For the same pragmatic reasons, this Court should reject Hawaii's contention that the political process is sufficiently robust to protect property owners from oppression by the majority. Pet. Mer. Brf. at 37-42. While that might be true of Chevron because it has enough resources to do battle in the

political arena, it is not true of most property owners. Amici, for example, do not have Chevron's resources. SPOSF's members typically own 2-6 unit buildings and the members of SFAA and CAA typically own 5-100 unit buildings. In jurisdictions like San Francisco, where 65% of the voters are tenants, the minority of property owners cannot protect themselves from the political process. Justice Holmes' prediction that, "the natural tendency of human nature" is to expand the police power until "private property disappear[ed]," *Pennsylvania Coal*, 260 U.S. at 415, has proven true: "private property . . . is now extinct in San Francisco[, which] has implemented a neo-feudal regime where the nominal owner of property must use that property according to the preferences of the majorit[y]". *San Remo Hotel v. San Francisco*, 27 Cal.4th 643, 692 (2002) (Brown, dissenting). If property owners are protected at all, it will be through the courts.

In sum, Hawaii has chosen to make a small case involving a few gasoline stations into a reason to overrule this Court's decisions and give cities and states free rein to violate the Takings Clause. In the process, Hawaii has shown that the substantial advancement test is even more vital now than it was 25 years ago when *Agins* was decided.

A. The Takings Clause Does Not Prohibit Government Action; It Ensures that No Group is Singled Out to Bear the Cost of a Public Burden

The Takings Clause is perhaps the most disarming of the Bill of Right's protections of the few against the tyranny of the many. Unlike the other provisions of the Bill of Rights, the Takings Clause does not prohibit government action. Instead, it requires only that government pay just compensation for its actions, thereby spreading the cost of its

actions benefitting the public to all taxpayers. As this Court explained in *First English Evangelical Lutheran Church v. Los Angeles*, 482 U.S. 304, 315 (1987):

> The basic understanding of the [Fifth] Amendment makes clear that it is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking.

In the end, the Takings Clause requires only what the legislators should know is right. When the courts enforce this constitutional right, they merely "bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

Hawaii hopes to transform this Takings Clause case into an enormous conflict between the courts and legislatures. According to Hawaii, the substantial advancement test under the Takings Clause has revived (or will revive) the *Lochner* era by allowing unelected judges to second-guess the wisdom of politically-popular economic regulations. Pet. Mer. Brf. at 39.

Even as a doctrinal matter, Hawaii's argument makes no sense at all. The Takings Clause does not prohibit government regulations, it simply requires the government to use tax dollars to accomplish its purpose rather than forcing a few to pay the cost. *First English*, 482 U.S. at 315; *Armstrong*, 364 U.S. at 49. By contrast, when a government regulation is found to violate the Due Process Clause, the government may not continue to enforce the regulation – even if the government were willing to pay the costs imposed by the regulation.

In the *Lochner* era, judges did use the Due Process Clause to second-guess legislative decisions and impose their own economic views. One reason that this Court ultimately overruled *Lochner* was to enable each state to try novel (and thus untested) solutions to economic problems. *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, dissenting) ("It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."). But, the Takings Clause does not call for judges to impose their economic views and thereby prevent economic regulations that are novel. The only issue for the courts under the Takings Clause is who pays for the novel or experimental solutions.[2] Thus, Hawaii's point fails at the threshold. Under the Takings Clause, the courts cannot second-guess legislative judgments or usurp legislative power. At most, the courts can direct the state to pay for the cost of their own legislation. That is, unless -- as in this case -- the government refuses to pay.

B. Even If Invalidation Were the Wrong Remedy in this Case, That Does Not Affect the Issue of Whether Heightened Scrutiny Is Required by the Fifth Amendment

The State makes much of the fact that the remedy chosen by the lower courts in this case was to invalidate Hawaii's rent control law. The State argues that the invalidation

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[2] Of course, a different issue is presented when a governmental taking of property is challenged on the ground that it is not for a public use. In that case, the proper remedy is not compensation, it is an injunction. This Court is considering the scope of the public use requirement in *Kelo v. New London*, No. 04-108.

remedy shows that the substantial advancement test is really a substantive due process test. The State's underlying premise is correct: the courts may not unilaterally order invalidation as the remedy for a taking. Instead, the courts are required to give the government the option of either paying just compensation or accepting invalidation of the regulation and paying temporary takings damages for the time that the regulation was in effect. *First English*, 482 U.S. at 321 ("Once a court determines that a taking has occurred, the government retains the whole range of options already available – amendment of the regulation, withdrawal of the invalidated regulation, or exercise of eminent domain.").

However, it is often quite obvious that the government has no desire or intention to pay just compensation. In those cases, this Court has not hesitated to invalidate a regulation once it was found to be a taking. E.g., *Babbitt v. Youpee*, 519 U.S. 234, 243-245 (1997).

In this case, Hawaii's rent control law does not provide for compensation, nor did the State argue in the lower courts that the right remedy was an order requiring it to provide compensation to Chevron. As this Court explained in *First English*, "a governmental body may acquiesce in a judicial declaration that one of its ordinances has effected an unconstitutional taking of property; the landowner has no right under the Just Compensation Clause to insist that a 'temporary' taking be deemed a permanent taking." *First English*, 482 U.S. at 317. In other words, a government, like Hawaii, may choose not to contest the remedy of invalidation because it is simply not willing to pay just compensation. Apparently, some legislative experiments – like Hawaii's

gasoline station rent control – are only worth trying if someone else pays the price.[3]

Ultimately, whether the remedy of invalidation is the proper remedy in this case is irrelevant to the real issue raised by the State: should this Court overrule its prior precedents establishing that there is a different standard of review under the substantial advancement test of the Takings Clause than the rational basis test of the Due Process Clause. The legislature's ability to advance the public good (according to its own views of social and economic policy) is unaffected by the Takings Clause. *Nollan*, 483 U.S. at 841-842 ("California is free to advance its 'comprehensive program,' if it wishes, by using its power of eminent domain for this 'public purpose,' [; but . . .] it must pay for it.").

This case proves the point. Whether Hawaii (explicitly or implicitly) acquiesced in the lower courts' remedy invalidating its legislation is completely irrelevant to the issue of the correct standard of review. If the incorrect remedy is the linch-pin of the State's position as its merits brief seems to indicate, there is a simple solution: remand the case with a direction that the lower courts order the State to choose between paying just compensation or accepting the invalidation of its legislation.[4]

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[3] Senator Russell Long explained a similar difficulty in adopting tax reform, most voters subscribe to the philosophy of "Don't tax you, don't tax me, tax that fellow behind the tree." Fred R. Shapiro, *The Oxford Dictionary of American Legal Quotations* 401 (Oxford Univ. Press 1993), quoting *Forbes*, Dec, 15, 1976.

[4] One solution to the problem posed by the dispute over the remedy in this case and avoid a fact question about whether the government silently acquiesced to the invalidation remedy is for the

II. HEIGHTENED SCRUTINY IS NECESSARY TO INSURE THAT PUBLIC COSTS ARE NOT SHIFTED TO PARTICULAR PROPERTY OWNERS UNDER THE GUISE OF ORDINARY ECONOMIC REGULATIONS

The regulatory takings doctrine has its modern roots in a seminal opinion by Justice Oliver Wendell Holmes, who explained:

> The general rule at least is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking. . . . . We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change.

Pennsylvania Coal, 260 U.S. at 415-416.

In that opinion, the Court discussed rent control that was imposed during World War I and concluded that while it was "to the verge of the law", it was not a taking because of the exigencies of the war-time "emergency". *Id.* at 416, citing *Block v. Hirsh*, 256 U.S. 135 (1921). Hawaii's legislation is, of course, not justified by any emergency, and is not even near the verge of a constitutional measure. Its rent control

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trial courts to routinely require defendants in takings cases to explicitly elect between just compensation and invalidation plus temporary takings damages before trial. In addition to insuring that the government's right to select the remedy is observed, that practice would help both the parties and the courts manage the trial of takings cases: the issues at trial will be quite different depending on which remedy the government selects.

regulation for a few gasoline station operators plainly goes "too far" and requires just compensation under the Takings Clause. But, Hawaii asks for more than just this Court's approval of this piece of legislation. Hawaii asks that this Court abandon the very doctrine that allows the courts to determine whether legislation has gone too far.

The substantial advancement test should be protected, not abandoned, because it enables the courts to distinguish between regulations that adjust the ordinary benefits and burdens of economic relations from regulations that impose an unfair burden on a few property owners. *Nollan*, 483 U.S. at 834-837 (substantial advancement test distinguishes an ordinary economic regulation from "'an out-and-out plan of extortion'"); *cf. Lucas*, 505 U.S. at 1017-1018 (economically viable use test distinguishes ordinary economic regulations that adjust the "benefits and burdens of economic life" from regulations that "carry with them a heightened risk that private property is being pressed into some form of public service under the guise of mitigating serous public harm."). The substantial advancement test protects property owners from the significant danger that the government has used the opportunity created by the immobility of real property to single out a few owners (in this case, two oil companies) and unfairly impose the cost of a public good on those property owners.

Hawaii's regulation poses precisely the same danger that was identified in *Nollan* and *Dolan*. Chevron alleged that the State leveraged its power to regulate property in order to impose the cost of public burdens on property owners.[5]

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[5] In this case, the State regulated particular pieces of real property, i.e., the land under gasoline stations. Thus, the State's reliance on Justice Kennedy's concurrence in *Eastern Enterprises* is irrelevant

While Hawaii admits that heightened scrutiny under the substantial advancement test was appropriate in *Nollan* and *Dolan*, it asks the courts to abandon that test in this case and preclude the courts from determining whether Chevron's allegation was true. Hawaii argues that the courts should only apply heightened scrutiny to review exactions imposed on a single property owner in an administrative proceeding. Pet. Mer. Brf. at 33-35.

If that were the only way that governments could violate the Takings Clause, that might be a viable argument. But there are many ways for governments to transfer wealth, and to violate the Constitution. In this case, Chevron's rights are equally violated by this legislative regulation requiring it to subsidize Hawaiian gasoline distributors as they would be by an administrative regulation exacting payments to Hawaii to fund the subsidy. In either case, Hawaii has leveraged its police power to compel Chevron to pay for this legislation in the name of the "public good."[6]

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because the issue in that concurrence was whether the Takings Clause should apply to economic regulations that do not operate on particular pieces of real property. *Eastern Enterprises v. Apfel*, 524 U.S. 498, 540-542 (1998).

[6] Even if this Court were to decide that legislation imposing an economic regulation is only subject to deferential scrutiny, it should not reach the issue of whether the same level of scrutiny is applicable to legislation imposing exactions. While the consequences to the property owner are the same, the dangers of governmental leveraging are obviously greater when the government requires real property owners to give their property (in cash or fee title) directly to the government. *Town of Flower Mound v. Stafford Estates, Ltd.*, 135 S.W.3d 620 (2004).

Moreover, the State's administrative/legislative distinction is indefensible. "A city council can take property just as well as a planning commission can." *Parking Ass'n of Georgia, Inc. v. City of Atlanta*, 515 U.S. 1116, 1117-1118 (1995) (Justices Thomas and O'Connor, dissenting from denial of certiorari). The fact that the State chose to impose this regulation by legislation on the two oil companies that leased gasoline stations, rather than by administrative action, should hardly make a constitutional difference.[7] Constitutional rights should not turn on whether the cities and states choose to ask their legislators to act unconstitutionally or ask their administrators to do so.

Nollan provides an apt example. While creating an easement for public beach access was a legitimate government purpose, the State of California could have taken the easement by legislation just as easily as it did in the administrative process. In any event, California chose not to pay for the

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[7] It is true that legislative procedures and administrative procedures are different. Thus, it may make sense to treat regulations imposed by an administrative agency somewhat differently than those imposed by a legislature. For example, under *Nollan* and *Dolan*, the government bears the burden of proving that the administrative action substantially advances a legitimate government purpose. That burden is justified because the administrative agency has a quasi-judicial procedure to gather admissible evidence and must base its decision on that evidence. By contrast, the legislative process is usually not based on admissible evidence gathered before the law is adopted. As a result, it may be appropriate to place the burden of proof on the property owner to establish that a legislative regulation fails the substantial advancement test. *Ehrlich v. Culver City*, 12 Cal.4th 854, 906 (1996) (Kennard and Baxter, concurring). Other than that, there is no justification for treating legislation and administrative actions differently under the substantial advancement test.

easement. *Nollan*, 483 U.S. at 841-842 ("California is free to advance its 'comprehensive program,' if it wishes, by using its power of eminent domain for this 'public purpose,' [; but . . .] it must pay for it."). The problem faced by California was that it did not have a good reason to require the Nollans to provide the easement by legislative or administrative regulation: the Nollans did not cause the lack of access. The only problem that they caused was a lack of visual access, and that problem could not be solved by requiring them to provide an easement for public beach access.

Dolan provides another example. In *Dolan*, the city took title to land instead of requiring flood control measures, i.e., took more than was needed to satisfy its ostensible purpose. Again, the substantial advancement test enabled the courts to determine whether the city's proffered purpose was advanced by the regulation. If not, the purpose of the economic regulation must have been to shift the cost of the public good to the regulated property owners. *Dolan*, 512 U.S. at 387-388, 392-395.

Here, when Hawaii adopted gasoline station rent control, its proffered purpose was to lower gasoline prices. But, the lower courts properly determined that was not the true purpose because the law will not actually lower gasoline prices. The only result that was absolutely certain from the legislation was that Chevron would subsidize gasoline station operators by reducing their costs. While that subsidy may not be unconstitutional under the Takings Clause, Hawaii was required to pay the cost of the subsidy, rather than impose the cost on Chevron.

The courts could not have made that determination without the substantial advancement test. If that test were abandoned, as Hawaii urges, the courts would be completely precluded

from making any significant inquiry into the critical question under the Takings Clause: whether the government is forcing "some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

In sum, the lower courts followed this Court's prior holdings under the Takings Clause and, if those holdings are abandoned, state and local governments will be free to ignore the Takings Clause in their future legislation and administrative decisions.

CONCLUSION

More than two decades ago, this Court held that legislatures may take private property only to substantially advance a public purpose. That holding has been followed by the courts and has not prevented legislators from acting within their constitutional limits. If affirmed, this case will be no exception.

Respectfully Submitted,

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